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No. 12,465.

United States Court of Appeals

FOR THE SIXTH CIRCUIT.

HENRY P. WHITE, and ESTATE OF NANCY A. WHITE, deceased,
T. LEO SULLIVAN, ADMINISTRATOR, C. T. A.,
Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

ON PETITION FOR REVIEW OF DECISION OF THE TAX COURT OF THE UNITED STATES.

BRIEF AND APPENDIX OF PETITIONERS.

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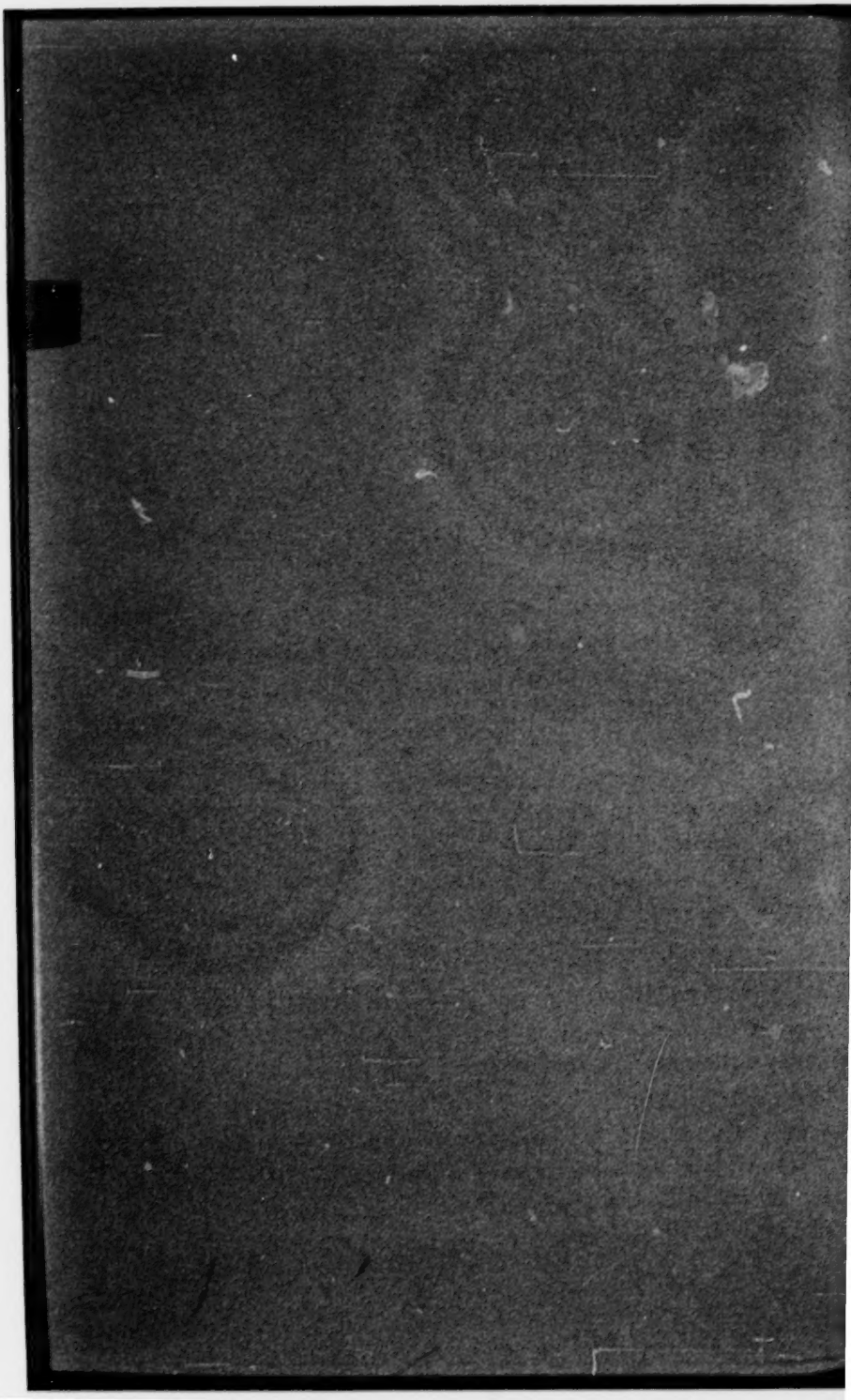

STATEMENT OF THE QUESTIONS INVOLVED.

1. Was the taxpayer, Henry P. White, in his operation of a wholly owned laboratory specializing in guns and ammunition research and related matters, in the years 1948 and 1949 engaged in conduct of a business of such character that his ordinary and necessary expenses of such business were properly deductible from the taxpayers' gross income under provision of Internal Revenue Code of 1939, section 23 (a) (1) (A) in computing the taxable income of himself and wife upon their joint returns for those years?

The Court answered this question "No."

The taxpayers contend that the answer should be "Yes."

2. Two issues presented by the pleadings were determined by the Tax Court.

One involved the question whether there were deficiencies of the joint income tax liability of the taxpayers, who were husband and wife, for the calendar year 1948 of $1,088.51, and for the year 1949 of $10,014.28, or in the total amount of $11,102.79.

The Court answered this question "Yes."

The taxpayers contend that the answer should be "No."

3. The other issue involved the question of the taxpayers' right to a refund of $7,671.75 which had been duly claimed by them as overpayment of income tax for the year 1948.

This claimed overpayment was the sum of two items: One was the consequence of an arithmetical error to the disadvantage of the taxpayers upon the face of the taxpayers' return for that year, and the other the amount of understatement of estimated tax paid.

That there were such errors was conceded by the Commissioner, and by counsel for the respondent upon the trial.

By its decision that there was a deficiency for the year 1948, the Tax Court answered this question of the right to refund "No."

The taxpayers contend that the answer should be "Yes."

The Court did not enter particular decision upon the question of right to this refund.

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No. 12,445.

United States Court of Appeals

FOR THE SIXTH CIRCUIT.

HENRY P. WHITE, and ESTATE OF NANCY A. WHITE, deceased,

T. LEO SULLIVAN, ADMINISTRATOR, C. T. A.,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON PETITION FOR REVIEW OF DECISION OF THE TAX COURT OF THE UNITED STATES.

BRIEF OF PETITIONERS.

STATEMENT OF FACTS.

A. NATURE OF THE ACTION.

This case is in this Court on a petition for review from a decision of The Tax Court of the United States, entered of record October 19, 1953.

The petitioners were Henry P. White and Nancy A. White, husband and wife, who filed their action in the Tax Court for the redetermination of income tax deficiencies as claimed by the Commissioner of Internal Revenue, for the years 1948 and 1949.

The Tax Court sustained the findings of the Commissioner on the sole ground that deductions of expenses of a business conducted by the taxpayer Henry P. White, were not ordinary and necessary expenses of a "business"

within contemplation of Sec. 23 (a) (1) (A) of the 1939 Internal Revenue Code. (72a.)

The question of the right to a refund for the year 1948 was also in issue.

In holding that there was a deficiency for the year 1948 the Court determined this question against the claim of the taxpayers, but made no specific entry with regard to it.

B. THE PLEADINGS AND PROCEEDINGS.

The pleadings are the taxpayers' petition and an answer of the Commissioner of Internal Revenue. (2a-11a.)

The questions and issues determined are stated in the prefixed Statement of the Questions Involved.

The case was tried in Cleveland, Ohio, November 11, 1952, before his Honor Clarence V. Opper. His decision that there were deficiencies in income tax of $1,088.51 for 1948 and of $10,014.28 for 1949 was entered of record October 19, 1954. (72a.)

C. THE FACTS.

The Tax Court, under the heading "Findings of Fact" made certain findings and stated certain conclusions. (65a-69a.)

These findings were not numbered, and we have presumed to number them 1 to 14 inclusive in the appendix for the purpose of reference to them separately.

In the argument we shall undertake to direct attention to the inferences and conclusions in some of the numbered paragraphs which we think this Court will find are not supported by any substantial evidence, and which clearly are not warranted upon the entire undisputed evidence and in consideration of the law.

Facts in Evidence to Which the Tax Court's Findings and Opinion Do Not Make Reference.

Very many of the evidential facts essential to determination of the principal question in this case appear in the testimony of the witnesses, which, as printed in the appendix, is detailed here.

Many of the most important of these facts are not referred to in the findings and opinion of the Tax Court.

D. SUBSTANCE OF THE PROOF.

Facts Shown by the Testimony of Henry P. White.

DIRECT:

The taxpayer Henry P. White, testified that his present residence in Bel Air, Maryland, is located about 11 miles from his present installation at Bel Air, and he gave as his reason for locating his new and much larger plant in that region, that it was not too far from Washington and New York and the New England arms manufacturing district, and relatively close to several army and navy proving grounds.

He described the much larger indoor range at Bel Air, and a 400 meter out-door range.

He testified to service of his business to the Government, and to the fact that at the time of the trial he was engaged in performance of a contract with the Navy. (32a-33a.)

He testified that his laboratory had regular hours and that the hours of work were from 8 in the morning until 4:30 in the afternoon, and that he had a time card system. (34a.)

The new laboratory has high speed photographic equipment necessary for the analysis of types of bullet motion as well as certain types of high speed machine

motion. It has a motion picture camera which runs close to 6000 frames per second; and a microflash unit which is a very high speed photo flashlight which enables the capture of a high speed projectile in motion, and its analysis from a photographic plate. (35a-36a.)

A book or catalogue on "cartridge manufacturers and base markings" which was prepared by his organization was sold to various of the agencies of the Government including the Armed Forces, The Federal Bureau of Investigation, and to the law enforcement agencies and peace organizations. (36a-37a.)

This book was marked Exhibit C but was not offered in evidence by either party.

The laboratory had served the National Rifle Association, among others, and the evidence shows that this organization has more than 300,000 dues paying members.

He testified to expectation of important business relations with the National Rifle Association, and that his was the only laboratory in the United States having to do with firearms that is not associated directly with one of the arms or munitions manufacturers. (38a-39a.)

He was doing considerably more business in 1953 than at the same time the year before, and he had confidence that his business would operate in the black in 1954. (39a-40a.)

Mr. White at the time of the trial was spending 90 per cent of his time on laboratory work. (40a.)

Exhibits 1 and 2 were received in evidence. (37a-38a.) Exhibit 1 is a prospectus with photo reproductions of the H. P. White Laboratory at Bel Air, Maryland.

Exhibit 2, dated February 1939, is a letter signed by Guy T. Helvering, Commissioner, designating H. P. White Company as a research laboratory entitled to the exemp-

tion prescribed in section 4 (5) of the Federal Firearms Act.

Exhibit 3 which was a photostat of a private letter, was objected to and not received in evidence.

Mr. White testified directly and positively that at the time when he initiated the Laboratory venture it was his intention to sell his services to the public, and that it was his intention to make a profit; that he consulted with others whom he named, before he went into it.

Among them was the witness Col. Goddard, who was a recognized expert and of long experience in the ballistics field. (40a-41a.)

Mr. White was in the armed services for almost four years during the war, stationed at Aberdeen on 24 hour duty. (41a.)

Exhibits 4 and 5, which were the taxpayers' returns for 1948 and 1949 were received in evidence. (42a.)

CROSS EXAMINATION.

His testimony here shows that White conceived the idea of establishing his laboratory in the winter of 1935; that at about that time he was receiving a moderate income from trusts which had been established for his benefit. In value the trust estate was about two million dollars.

He did not receive any part of the principal of the trust estate in possession until he was 30 years of age. (45a.)

In 1948 The White Laboratory was doing work for the National Rifle Association, and he had installed before that what is described as a universal mount and pressure gun set-up, and White's was the only independent laboratory in the United States which had such equipment.

After the war there was a tremendous amount of material, the cataloguing, measuring, taking cartridges apart, and analysis and weighing the powders of which was, as Mr. White testified—"a tremendous undertaking."

He had acquired thirteen or fourteen thousand rounds of different types of ammunition and his work of this kind had resulted in what he described as being "like a very large and comprehensive library that you go to and get what you want." (46a-47a.)

About in 1948, White published a technical book on Center Fire Metric Pistol and Revolver Cartridges (Exhibit A), and about in 1950, another book entitled Center Fire American and British Pistol and Revolver Cartridges (Exhibit B). (48a-50a.)

Exhibit C was another book to which reference was again made in the cross examination, but it was not offered in evidence. (50a-51a.) Services were rendered to The Ohio Edison Company among others. (51a.)

Exhibit C is referred to as a catalogue of cartridge identification, and some copies were sold to the F. B. I. and the Army, among others. The price was $50.00. (53a.)

Because of its confidential nature this book was not printed in the usual way, but was reproduced from blue prints. (54a.)

White had a cost system for the laboratory in 1948 and 1949 and an improved system after the removal to Maryland. (52a.)

RE-DIRECT EXAMINATION OF H. P. WHITE.

Mr. White and his assistantt, Mr. Munhall, actively solicit business. (55a.)

At the time of the trial the laboratory had on hand from 40,000 to 50,000 rounds of government automatic cannon ammunition, twenty millimeter shells; the laboratory at Bel Air could handle shells of as large caliber as between 20 and 30 millimeters; both guns and ammunition were involved in the government contract being performed at the time of the trial.

Only 45 caliber rifle ammunition could be handled at the White Laboratory in Cleveland. (56a-57a.)

QUESTIONS BY THE COURT.

Q. Do you have an estimate how much capital investment is involved in the plant that is shown in that exhibit? (Ex. 1.) The witness answered: Yes, sir, I should say in the neighborhood of $300,000. (63a.)

In answer to further questions asked by the Court the witness White testified that the highest figure of expense shown by the schedules filed with the 1948 and 1949 returns was for salaries paid in the conduct of the business. (59a-60a.)

He testified with regard to the figures shown for advertising (61a-62a), and to the figures for depreciation. (62a.)

He gave the location of his business before moving to Bel Air. His laboratory was located at E. 90th Street and Euclid Avenue in Cleveland, Ohio.

FURTHER RE-DIRECT EXAMINATION.

The witness testified that he was a sailboat hobbyist. (64a.)

Testimony of Other Witnesses.

Facts shown by the testimony of the witness **Calvin H. Goddard**. Direct:

This witness was a pioneer in the ballistics field whose work was instrumental in developing the science of bullet identification as now in use throughout the world. He, with associates, worked in this field for some years without any return in money. (17a-19a.)

He described the activities of persons who load their own ammunition in effort to obtain more accurate results than are obtainable by use of commercial ammunition and because of saving in cost. These people are known as hand loaders or self loaders.

The White Laboratory can and does render service to such people. (20a-22a.)

Facts shown by testimony of the witness **E. W. Kronbach**. Direct:

Mr. Kronbach is an employee of The Van Dorn Iron Works Company and was engaged in metallurgical work.

About in 1940-41 the Van Dorn Company had received an educational order from the Government for three complete tanks.

They were having a great deal of difficulty in making tests of armor plate, and found that there were few sources of information to aid them in their experiments.

They were put in touch with H. P. White Laboratory which supplied the equipment and information to enable The Van Dorn Company to check the speed of projectiles fired at armor plate in making their tests of such plate.

The Laboratory also assisted in their experimentation. (23a-27a.)

As Mr. Kronbach described it the service was extremely valuable to his company. (25a-26a.)

Facts as shown by testimony of the witness **Arthur E. Hart**. Direct:

Mr. Hart is a gunsmith of long experience and deals in guns and ammunition in Cleveland as the Hart Arms Company. (27a-28a.)

He recommended the White Laboratory to hand loaders.

Facts as shown by testimony of the witness **Harley E. Benthum**. Direct:

Mr. Benthum was Chief of Police of Shaker Heights, Ohio. His department had employed the services of H. P. White Laboratory in 1947 and had again consulted them with regard to type and quantity of powder to be used in hand loading. (28a-30a.)

On re-direct examination the witness testified that the service rendered was very important. (30a.)

Facts shown by testimony of the witness **T. Dickerson Cook**. Direct:

Mr. Cook is director of the Institute of Applied Science in Chicago. It conducts a home study school; identification and investigation work.

Its graduates go into identification bureaus and law enforcement agencies.

His business employed H. P. White Laboratories to rewrite instruction lessons on firearms identification, which are being currently used by its students.

The witness testified that his business had students and graduates in over 50 countries. (30a-31a.)

THE ARGUMENT.

THE FIRST QUESTION INVOLVED.

1. Was the taxpayer, Henry P. White, in his operation of a wholly owned laboratory specializing in guns and ammunition research and related matters, in the years 1948 and 1949 engaged in conduct of a business of such character that his ordinary and necessary expenses of such business were properly deductible from taxpayers' gross income under provision of Internal Revenue Code of 1939, section 23 (a) (1) (A) in computing the taxable income of himself and wife upon their joint returns for those years?

The Tax Court answered this question "No."

The taxpayers contend that the answer should be "Yes."

It is submitted that all of the cases in which the Courts have held that claimed ordinary and necessary business expenses, or losses, of an individual were not deductible on the ground that a purported business was not such within the intent of Internal Revenue Code Section 23 (a) (1) (A), fall generally into one or the other of three classes.

(1) The purported business, as in the case of the conduct of a country estate or of a farm, was a part of the mode of living of the taxpayer.

(2) The purported business was not such because its real conduct or purpose was not the making of profit, but *primarily* was the self gratification of the owner in some other way than by the acquisition of gain. Such cases are well described as hobby cases.

(3) That the real purpose of the purported business was the evasion of taxes.

We believe that no case will be found, other than the present case, in which a business having all of the indicia which, in common acceptation, would place it within the classification of a business, has been held not to be such within the intent of Section 23 of the Internal Revenue Code, upon evidence only:

(a) That the owner was a wealthy man.

(b) And that the business had never made money.

The Authorities Cited in the Tax Court's Opinion.

The Tax Court in its opinion had cited five cases, no one of which appears to support either the conclusions which the Court reached in the present case or its decision.

The first of these is:

Deering vs. Blair, Commissioner, 23 F. 2nd. 975-976, C. C. A. D. C.

The facts show that Reginald C. Vanderbilt had owned a very extensive country place, which was also operated as a stock farm; that he had little or nothing to do with the actual conduct of the business affairs of the property, and that the losses were continuous and heavy.

The Tax Court in its opinion said, page 976:

"In view of this apparently unbroken record extending from the beginning to the close of Mr. Vanderbilt's operation of the farm, we think that the Board was justified in the conclusion *that the farm was operated as a place of pleasure, exhibition, and social diversion.*"

But the Court in its opinion also stated, page 976:

"An occupation or employment will not be excluded from the *classification of business merely because it actually results in loss instead of profit.*"

All emphasis in quotations from authorities in this brief is added unless otherwise noted.

Comment: It will be noted that the "character" of the operation supported by the fact that it entailed losses, influenced the decision that the losses were not deductible.

That the conduct of the White Laboratory from its inception was and is a business in any ordinary acceptance of the word, can hardly be questioned.

And certainly the modest way in which Mr. White's business was begun and carried on from 1936 to 1952, when he removed to Bel Air, would not indicate any possible purpose to relate it to "exhibition and social diversion." (45a-46a.)

The second case cited in the Tax Court's opinion is:

Chaloner vs. Helvering, Commissioner, 69 F. 2d, 571, C. C. A. Dist. Col. (1934).

In a per curiam it is said, page 572:

> "* * * The record discloses that petitioner is an independently wealthy man, who for twenty years has indulged *his hobby for writing books without realizing any income therefrom.* The only thing he has to show for his work is a warehouse full of books. * * *"

Comment: The facts of the *Chaloner* case certainly disclose no parallel with those of the present case.

The *Chaloner* case definitely is a "hobby" case with no complications.

The activities of the taxpayer there had none of the indicia, and nothing of the character of a business.

The third case cited by the Court is:

Thacher v. Lowe, 288 Fed. 994, Dist. Court S. D. N. Y. (1922.)

This again was a case involving the operation of a farm, in this instance by a lawyer at his place of residence. The Court said, page 994:

> "I have no doubt that a lawyer may operate a farm for profit. However unlikely it may be that he will succeed in the business, the enterprise *may in fact be intended as a business.*
>
> But it is equally clear that a lawyer may run his farm merely as an adjunct to his country place *and between the two the test appears to me to be only of his actual intention.* Moreover, in ascertaining that intention, I can see no escape from making the crux of the determination his receipts and expenditures."

Comment: It is plain that the latter statement is not one of a principle or rule of law, but plainly one apt and intended to be applicable to the particular facts of the case there under consideration, which, equally plainly, it was.

In the present case the evidence *does not* present a question whether the enterprise was *intended* to be a business. Mr. White has testified to his purpose and intention. (40a.)

Every fact in evidence supports his testimony unless it can be said that his business was not a business because it did not make money.

The fourth case cited in the Tax Court's opinion is:

Louise Cheney, 22 B. T. A. 672-674.

This case involved operation of a farm by the taxpayers primarily with purpose to supply themselves with milk and other produce, the incidental surplus being offered first to farm employees, upon all of which a bookkeeping charge was made, and the remainder sold to others.

It was held "upon all of the evidence not to be operated as a business, and losses sustained not deductible." Opinion, page 674:

> "The primary intention was not to run a business or to make a profit, but to produce good food for home consumption * * * It would be specious to say that a vain hope that on some remote day a profit *may result is enough to give the operation of the farm the character of a trade or business.* It is far different from saying, as the Board and Courts have in other cases, *that the fact of a loss does not deprive a business enterprise of its character as a business.*"

Comment: Like the *Deering* case, this case is within the first classification above mentioned. The farm was conducted, not primarily as a business, but as an adjunct to the mode of living of the taxpayers.

(There was a dissent in the *Cheney* case).

The Tax Court's opinion next quotes from:

Cecil v. Commissioner, 100 F. 2d., 896, 899, C. C. A. 4th (1939.)

This case involved conduct of Biltmore House and gardens as open to the public for an admission charge. The case is very carefully considered and we beg leave to quote from it at some length. The Board had held that the expenses of the operation were not deductible.

Headnotes 4, 5 and 8 read:

> "(4) That substantial losses rather than some net profit have resulted does not prevent enterprise carried on by taxpayer from being a 'business' within the meaning of statute permitting deduction of necessary expenses paid or incurred in carrying on a business.
>
> Revenue Act 1928, Section 23 (a) 26 U. S. C. A. Section 23 (a)."

"(5) If gross receipts from any enterprise are practically negligible, in comparison with expenditures, inference may be compelled *that taxpayers' real motives were personal pleasure* and prevent deduction of expenses incurred in carrying on the enterprise.

Revenue Act of 1928, Sec. 23 (a) 26 U. S. C. A. Sec. 23 (a)."

Comment: It is submitted that there is no evidence of any kind in the present case upon which to base a conclusion or fair inference that the taxpayer was devoting his time to arduous activity and risking his capital for pleasure or self gratification, unless such inference can be drawn alone from the fact that the taxpayer was wealthy and that his enterprise did not make money.

Headnote—(8) "To constitute a bona fide 'business' so far as to entitle taxpayer to deduct necessary expenses from income, the expenses of operation and the facts as a whole must exclude a finding that the enterprise was only a scheme of tax evasion * * *."

Comment: It is apparent in the present case from the taxpayers' 1948 and 1949 tax returns that losses were greater than the amounts which additionally would have been paid in taxes if there had been no such losses. There was no intimation by the Court or Counsel that there was in this case any purpose to avoid just taxes.

In its opinion page 898, the Court of Appeals said:

"In our opinion the Board acted on a too narrow and restricted interpretation of the statute. The term 'business' as here used was evidently not intended to have a technical meaning, but to be understood in its ordinary acceptation * * *

In United States v. Atlantic Coast Line Co., 4 Cir. 99 F. 2d., 6, 7, this Court in an opinion by Judge Northcott, approved the definition given in Black's

Law Dictionary, that 'business' is a very comprehensive term, and embraces everything about which a person can be employed * * *

In the adjudicated cases which have applied the word as used in section 23 (a) of the Revenue Act of 1928, and in corresponding sections of other income statutes, there is a recurrent expression that the enterprise must have been undertaken for 'gain or profit' and in many of the cases, the test is stated in terms which generally distinguish between 'business and pleasure'."

Comment: In the present case Mr. White's testimony that he intended to sell his services to the public and that he expected to make a profit, surely must be given full credit. (40a.)

In his opening statement counsel for the respondent said: "We do not exactly contend that this man's operations are a hobby, nor that it does not serve a useful purpose." (16a.)

Authorities Other Than Those Cited In the Tax Court's Opinion Upon the First Question Involved.

In

Foran et al., v. Commissioner, 165 F. 2d 705, C. C. A. 5th (January, 1948),

the question was whether the income was capital gain or ordinary income. It was held to be capital gain.

The Court in its opinion said, page 707:

"Also cited is Greene v. Commissioner, 5 Cir. 141 F. 2d 645-646. The distinction between that case and this is found in the majority opinion in these words:

'There was no direct proof of intent or purpose even in the testimony of Mr. Greene the taxpayer, and the Tax Court was required to draw inference

as to this ultimate fact from the circumstantial evidence relevant thereto.'

Here there is direct and positive evidence from the witness who best knows, that this property was for eighteen months being held as an investment and not for sale to customers."

Farish vs. Commissioner of Internal Revenue, 103 F. 2d 63, C. C. A. Fifth Circuit (1939).

From the Court's opinion, page 64:

"So far as the findings of the Board go they are supported by competent evidence but they omit relevant facts shown by the evidence in the record. As to both enterprises the partners testified they expected to make profit, and gave comprehensive reasons for that belief."

Headnote 4:

"The intention of the taxpayer entering partnership formed for breeding polo ponies was dominant factor in determining whether he engaged in venture merely for pleasure or whether he engaged in it for profit, so as to render losses incurred deductible in computing income tax.

Revenue Act 1932, Section 23, 26 U. S. C. A. Section 23."

Comment: In the *Farish* case as in the present case, the testimony as to intention and purpose had been disregarded by the Board.

The Court of Appeals held that the expenses were deductible.

Whitney v. Commissioner Internal Revenue, 73 Fed. 2d 589, C. C. A. 3rd (1934).

The case is concerned with the question of deductibility of expenses of a racing stable. There had been nothing but losses from 1918 when the stable was established, some twelve years. The Court said, page 592:

"There is no substantial evidence to support the conclusion that the pleasure of owning the stable was the primary interest of the petitioner in operating it."

The losses were held to be deductible.

The Court said further that the facts are so similar to those of *Commissioner v. Widener*, 33 Fed. (2d) 833, C. C. A. 3 (cited *post*) that it was controlling.

Comment: There is no evidence of any kind, substantial or other, in the present case, that pleasure in the exacting and arduous work which the conduct of this business demanded, was the primary reason why the business was begun or continued. The evidence is precisely to the contrary.

In

Doggett vs. Commissioner of Internal Revenue, 65 F. 2nd 191, C. C. A. D. C.

the question involved was whether the publication, advertising and sale of books written by an English religious teacher and prophetess for alleged benefit of the American people, and conducted with expectation of profit, was a business, and expenses thereof deductible in computing income tax.

The Court reversed the Commissioner, holding that they were. Headnotes 3 and 4 read:

"3. Proper test of determining whether enterprise constitutes 'business' so as to make expenses thereof deductible from income tax, *is not reasonableness of taxpayers' belief that profit will be realized*, but whether enterprise is entered into and carried on in good faith for purpose of making a profit, *or in belief that profit can be realized thereon, not merely for pleasure, exhibition, or social diversion.*

"4. Test of whether legitimate enterprise constitutes 'business' so as to make expenses thereof deduct-

ible from income tax is whether a person engaged therein shows willingness to invest time and capital on future outcome of enterprise, *whether it be successful or unsuccessful.*

Revenue Act 1926—Section 214(a)(1) 26 U. S. C. A. Section 955(a)(1)."

The Court in its opinion said, page 194:

"It certainly cannot be said that she is conducting this enterprise *either as a hobby or for recreation or pleasure;* and as said in George v. Commissioner, 22 B. T. A. 189; 'The real test is whether the operation was carried on as a business for gain or whether it was carried on for recreation or pleasure.'

And this question is largely a matter of the intent of the petitioner."

Comment: It need hardly be said that these are statements of settled principles of law and are apt to the facts in the case now before this Court.

In

Commissioner of Internal Revenue vs. Widener, 33 Fed. 2d 833, C. C. A. 3d.

the operation of a racing stable was involved. The Board held that the losses were deductible. From the Board's opinion, quoted by the Court, page 833:

"The fact that the petitioners were wealthy enough to afford a hazardous occupation in which they found pleasure despite discouraging losses does not establish the essential nature of the occupation. If they were utterly indifferent to whether there was loss or gain, or if it were shown that the stables were an incident to the social or domestic aspects of their daily lives, the result might be against them, as in Thacker vs. Lowe (D. C.) 288 Fed. 944, 2 A. F. T. R. 1931.

Instead it appears that they devoted themselves seriously and assiduously to the economic promotion of the stables, always in the hope that profit would result."

The Court of Appeals affirmed the determination of the Board.

In

George v. Commissioner, 22 B. T. A. 189, 195,

the Board said in its opinion, page 194:

"The remaining issue is whether or not petitioner operated two orchards as a business.

"*In our opinion the fact that petitioner sustained losses year after year may be of some evidentiary value*, but by itself that fact does not prove that the orchards were not carried on as a business, nor does the fact stressed by the respondent that petitioner had other and larger interests."

"The real test is whether the operation was carried on for recreation or pleasure. *And this question is largely a matter of the intent of the petitioner.*"

In

Edith G. Marx, Petitioner v. Commissioner Internal Revenue, Respondent, 5 T. C. 173,

the question was whether loss resulting from disposition of a yacht of which petitioner had become the owner by testamentary bequest was deductible.

From the opinion of Opper, J., page 174:

"The problem is to ascertain whether the transaction was entered into for profit. *That involves a consideration of the purpose of the principal participant*, although, to be sure, this may be ascertained from conduct as well as words."

The Court further said that:

> "The Petitioner has not used the yacht nor indulged in any conduct inconsistent with a purpose to turn the property to a profit."

The deduction of loss of value was allowed by the decision.

Comment: The Tax Court in the above case apparently gave considerable weight to the evidence as to intention of the taxpayer.

Other cases bearing upon the question of the intention and purpose of the taxpayer as being of controlling importance in considering the question whether he was conducting a business are:

Helvering v. Commissioner of Internal Revenue, 71 F. 2nd 586, C. C. A. 9th;

Margaret A. Amory, 22 B. T. A. 1398;

Lewis v. Commissioner, 34 B. T. A. 996.

The *Amory* case cited involved the conduct of a racing stable.

In its opinion in that case the Board said, page 1399:

> "Petitioner testified categorically that she entered the racing field with an eye to profit, that she would not have done so except she believed it could be profitable. She sought advice on this phase of the matter, and was advised that a racing stable could be operated profitably. * * *
>
> She negatived with vigor any suggestion that the racing stable was a hobby."

Comment: Mr. White testified similarly in the present case. We submit that there is no evidence which raises any question whatsoever of his credibility, and no such question has been raised.

The Tax Court's Inferences and Conclusions Stated Under the Heading "Findings of Fact."

First be it said that there is no dispute about any of the evidential facts in this case. There is no contradiction of any of the testimony of any witness for the taxpayers. No question is raised about the credibility of any of these witnesses. There were no witnesses for the respondent Commissioner.

In such a situation the Courts of Appeals will reach their own conclusions and draw their own inferences from the evidence. *Wright v. Bernet*, 172 F. 2d, 343, C. C. A. 6th; *United States v. United States Gypsum Company*, 333 U. S. 364 (Syl. 7), 68 S. Ct. 525; *Plomb Tool Company v. Sanger*, 193 F. 2d, 260-264, C. C. A. 9th (1952); *Wellington v. Commissioner*, 173 F. 2d, 421, C. C. A. 5th.

In

McGah v. Commissioner, 210 F. 2d, 769, C. C. A. 9th (1954)

Headnote 4 reads:

> "In petition to review decision of the Tax Court, Court of Appeals will give careful attention to the finding of the Tax Court, but will draw its own inferences from undisputed facts."

In considering these inferences and conclusions we ask the Court to bear in mind that they form the sole basis for the Tax Court's ultimate conclusion that the taxpayer was not conducting a "business" in 1948 and 1949, and for the decision that therefore he was not entitled to deduct the ordinary expenses of operating such business in computing his taxable income.

In finding No. 11 the Tax Court said:

> "The ballistics laboratory was of some service and benefit to a limited number of persons and organiza-

tions *but it was not capable of producing income in sufficient amount to off-set the usual expenses.*"

We submit that this was a violent assumption indeed, in view of the fact that here was a well equipped and well conducted establishment, in control of competent men with ample capital available when opportunity might present itself for employment of such capital.

The only evidential basis for such an assumption was that the business had not made money.

It is a matter of too common knowledge to be subject of dispute that in the field of mechanics such temporarily unsuccessful enterprises have gone on to achievement of great financial successes.

The tax returns in evidence show that depreciation was being taken on capital investment of $43,016.74 in 1948 and of $50,156.15 in 1949, which should indicate that the taxpayer had shown considerable confidence that he could make good even if the Court or counsel who suggested this finding did not.

In finding No. 12 the Court says:

"Petitioner had no real expectation of any net income for years subsequent to those in issue."

But even if the state of mind of the taxpayer at the time of the trial in 1953 as to the future prospects of his business was proper to be considered upon the issues before the Tax Court involving returns for 1948 and 1949, the evidence shows:

(a) That he had invested about $300,000.00 in a new plant at Bel Air, Maryland, beginning in 1952;

(b) At the time of the trial he was engaged in performance of an important contract with the U. S. Navy;

(c) He was expecting to have increased business relations with the National Rifle Association which would

be the culmination and fruition of efforts he had been making. (38a-39a.)

(d) He had had conversations, at least, about purchase of his new plant by that organization. (52a.)

The Tax Court considered that Mr. White, in maintaining his opinion as of the time of the trial in 1953, that his enterprise would be profitable, did not take into consideration interest on his new investment. There is no evidence that any interest had been paid, and again it is difficult to see how the issues are affected by the taxpayer's miscalculation as to his future if it was such miscalculation. The Tax Court also thought that it was significant that Mr. White had not charged anything for his services. We think that this is not unusual in connection with a wholly owned business, and certainly the Government could have no complaint because he kept his deductible expenses down.

Finding No. 13:

> "Petitioner did not operate the Ballistics Laboratory as a business or with intent of making a profit during the taxable years 1948 and 1949."

There is not a word or fact directly in evidence to support either of these conclusions. That he did operate it as a business with intention to make a profit, he testified clearly and positively.

If he had any other possible purpose it does not appear in the record of this case. Bearing in mind that Mr. White had embarked upon his venture as a pioneer in a new field; that he was without much experience of any kind in the beginning, and that he had spent four years in the armed forces in the interim, a belief might well have been warranted that in 1948 and 1949 he had made considerable progress, and the very valuable services

which had been rendered to The Van Dorn Company in the early forties would support such a view. (23a-27a.)

Finding No. 14:

"The expenditures claimed were neither ordinary nor necessary expenses of carrying on a trade or business nor losses within the meaning of Section 23 Internal Revenue Code of 1939."

This is the Court's ultimate conclusion and it is, upon the undisputed facts, a conclusion of law.

The statement is made, of course, with reference to White's situation in 1948 and 1949.

We do not definitely know from the findings just what the Court thought Mr. White was doing, if he was not intending to conduct a business in the sense which the word implies.

There is not a word or fact in evidence to indicate that he was devoted to his business as a hobby.

Counsel for the respondent in his opening statement was unwilling to say that it was a hobby. (16a.)

His business had no relation to his mode of living, nor to any aspect of his social life. By no possibility could it be considered to be conducted as a sporting venture of any kind.

Without the slightest question he never could have had any idea that he would be advantaged financially by incurring business expenses in excess of the amount of the tax deduction which resulted from deduction of his business expense.

In Conclusion on the First Question Involved.

We submit most earnestly that neither the evidence nor the law justify the Court's conclusions that the taxpayer in 1948 and 1949 was not conducting a business

within the intent and purpose of Section 23 of the Internal Revenue Code of 1939.

THE SECOND QUESTION INVOLVED.

2. Two issues presented by the pleadings were determined by the Tax Court.

One involved the question whether there were deficiencies of the joint income tax liability of the taxpayers, who were husband and wife, for the calendar year of 1948 of $1,088.51 and for the year 1949 of $10,014.28, or in the total amount of $11,102.79.

The Tax Court answered this question "Yes."

The taxpayers contend that the answer should be "No."

Little additional discussion of this question is necessary. If Mr. White was merely indulging a hobby in 1948 and 1949, then it would be admitted that his expenses would not be allowable as deductions.

The Tax Court's decision would seem to have been reached upon the theory that he was, but almost complete disregard of the convincing evidence to the contrary, as it is disregarded in the statements of the findings and opinion of the Court, is difficult to understand.

We can only repeat that the decision is not only not supported by any substantial evidence which can be controlling but that the authorities relied upon by the Tax Court and other authorities cited in this brief convincingly show that the decision is contrary to the intent and purpose of the law.

THE THIRD QUESTION INVOLVED.

3. The other issue involved the question of the taxpayers' right to refund of $7,671.75 which had been duly claimed by them as overpayment of income tax for the year 1948.

This claimed overpayment was the sum of two items: One was the consequence of an arithmetical error to the disadvantage of the taxpayers upon the face of the taxpayers' return for that year, and the other the amount of understatement of the estimated tax paid.

That there were such errors was conceded by the Commissioner, and by counsel for the respondent upon the trial.

By its decision that there was a deficiency for the year 1948, the Tax Court answered this question of the right to refund "No."

The taxpayers contend that the answer should be "Yes."

The Court did not enter particular decision upon the question of right to this refund.

This question, as it was presented by the pleadings, also was determined by the conclusion reached by the Court upon the First Question Involved.

The Commissioner had disallowed all of the business expenses, and the Court, in deciding that none of them was deductible under Section 23 of the Internal Revenue Code of 1939, because the taxpayer, in 1948 and 1949, was not conducting a business within the intent of that section, sustained the Commissioner in this action.

It necessarily followed that if there was a deficiency in 1948, there could be no refund.

SUMMARY.

What the decision of the Tax Court in this case means is that the Commissioner may undertake to impose a penalty upon the taxpayer's continued operation of his business by action which would deprive him of the statutory right to deduct his expenses in computing his taxable income, for no other reasons than that the business has not made money and that the taxpayer is wealthy.

How disastrous such a ruling, if sustained, might be is well exemplified in the present situation of this taxpayer.

We can only assert without fear of contradiction, that there is no statute which grants any such authority to the Commissioner of Internal Revenue, and no support in decision by the Courts for any such action by him.

RELIEF.

The decision of the Tax Court that there were deficiencies of income tax upon the returns of the taxpayers for the years 1948 and 1949 is erroneous and should be reversed.

An order should be made that the taxpayers are entitled to a refund of $7,671.75 as overpayment of income tax for the year 1948.

Respectfully submitted,

EDGAR S. BYERS,

Counsel for the Petitioners.

APPENDIX A.

Relevant Portions of Record on Appeal.

DOCKET No. 44257.

THE TAX COURT OF THE UNITED STATES

HENRY P. WHITE and NANCY A. WHITE,
AMENDED CAPTION: "HENRY P. WHITE, and ESTATE OF NANCY A. WHITE, DECEASED, T. LEO SULLIVAN, ADMINISTRATOR, C. T. A.,"

Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

See order of February 3, 1955.

DOCKET ENTRIES.

1952

Sept. 18—Petition received and filed. Taxpayers notified. Fee paid.
Sept. 19—Copy of petition served on General Counsel.
Sept. 18—Request for Circuit hearing in Cleveland, Ohio, filed by taxpayers. 10/2/52 Granted.
Nov. 12—Answer filed by General Counsel.
Nov. 18—Copy of answer served on taxpayers, Cleveland, Ohio.

1953

Sept. 17—Hearing set November 9, 1953, Cleveland, Ohio.
Nov. 11—Hearing had before Judge Opper, on merits. Briefs due January 11, 1954. Replies due February 10, 1954.
Nov. 23—Transcript of hearing 11/11/53 filed.

1954

Jan. 11—Brief filed by taxpayers. 1/12/54 Copy served.
Jan. 11—Brief filed by General Counsel. 1/12/54 Copy served.

Feb. 11—Reply brief filed by taxpayers. Copy served.
Oct. 19—Findings of fact and opinion filed, Judge, Opper. Decision will be entered for the respondent. Copy served.
Oct. 19—Decision entered, Opper, Judge, Div. 14.
Dec. 1—Entry of appearance of Edgar S. Byers as counsel filed.
Dec. 16—Motion to withdraw as counsel William Patrick Clyne filed. 12/17/54 Granted.

1955

Jan. 18—Petition for review by U. S. Court of Appeals, Sixth Circuit, filed by taxpayers.
Jan. 19—Proof of service filed.
Jan. 21—Designation of contents of record with acknowledgment of service thereon filed by petitioners.
Feb. 2—Motion to substitute personal representative for petitioner Nancy A. White, deceased, filed by taxpayers.
Feb. 3—Order, amending caption to read, Henry P. White, and Estate of Nancy A. White, Deceased, T. Leo Sullivan, Administrator, C. T. A., entered.

PETITION.

(Filed September 18, 1952.)

The above-named petitioners hereby petition for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (CLEVELAND IRA:90D) dated June 24, 1952, and as a basis of their proceeding allege as follows:

1. The petitioners are individuals, husband and wife, with residence at 2688 Landon Road, Shaker Heights, Ohio. The returns for the period involved were filed with the Collector of Internal Revenue for the 18th District of Ohio.

2. The notice of the deficiencies (a copy of which is attached hereto and marked "Exhibit A") was mailed to the petitioners on June 24th, 1952.

3. The deficiencies as determined by the Commissioner are in income taxes for the calendar years 1948 and 1949 in the following amounts:

Year	*Deficiency*
1948	$ 1,088.51
1949	10,014.28

making a total of $11,102.79, all of which is in controversy, and in addition thereto, the amount of $7,671.05 for the taxable year of 1948, previously overpaid by the petitioners is also in controversy.

4. The determination of tax set forth in said notice of deficiency is based upon the following errors:

(a) The Commissioner erred in the disallowance of losses sustained and deducted by the petitioners in the amount of $18,624.82 in their income tax return for the calendar year 1948.

(b) The Commissioner erred in failing to order a refund of income taxes paid by the petitioners as a result of the overstatement of taxable income in the amount of $14,414.40 in their 1948 income tax return.

(c) The Commissioner erred in failing to order a refund of taxes paid by the petitioners as a result of the understatement by the petitioners on their 1948 Declaration of Estimated Tax on their 1948 income tax return in the amount of $1,092.07.

(d) The Commissioner erred in the disallowance of losses sustained and deducted by the petitioners in the amount of $18,521.02 in their income tax return for the calendar year 1949.

5. The facts upon which the petitioners rely as a basis of this proceeding are as follows:

(a) That the petitioners' business is engineering and as such employ subordinates, and purchase materials and supplies necessary and essential to its conduct.

(b) That all of the deductions claimed and disallowed for the years 1948 and 1949, were in connection with the operation of their engineering business.

(c) That the petitioners understated their estimated tax paid in their 1948 income tax return in the amount of $1,092.07.

(d) That the losses sustained and deducted in their income tax return for the year of 1948 in the amount of $18,624.82, and for the year 1949 in the amount of $18,-521.02, were ordinary and necessary business losses incurred in the operation of their business.

(e) That the petitioners in filing their income tax return for the year of 1948, overstated their taxable income in the sum of $14,414.40 and paid the tax thereon as a result of an arithmetical error in the preparation and filing of the return.

WHEREFORE, the petitioners pray that this Court may hear the proceeding and determine that there is no deficiency in income tax due for the years 1948 and 1949; and that the petitioners are entitled to a refund for the calendar year 1948 in the amount of $7,671.05; and that the Court may grant such other and further relief as the nature of this case warrants.

WILLIAM PATRICK CLYNE,
Counsel for the Petitioners.

HENRY W. ROSEWATER,
Certified Public Accountant.

(Verification omitted.)

EXHIBIT "A."

U. S. TREASURY DEPARTMENT

Office of Internal Revenue Agent in Charge

404 Hanna Building

Cleveland 15, Ohio

Internal Revenue Service
CLEVELAND
IRA: 90D

JUN 24 1952

REGISTERED

Mr. Henry P. White and
Mrs. Nancy A. White, Husband and Wife
2688 Landon Road
Shaker Heights
Cleveland, Ohio

Dear Mr. and Mrs. White:

You are advised that the determination of your income tax liability for the taxable year(s) ended December 31, 1948 and 1949, discloses a deficiency of $11,102.79, as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency or deficiencies mentioned.

Within 90 days from the date of the mailing of this letter you may file a petition with The Tax Court of the United States, at its principal address, WASHINGTON 4, D. C., for a redetermination of the deficiency. In counting the 90 days you may not exclude any day unless the 90th day is a Saturday, Sunday, or legal holiday in the District of Columbia, in which event that day is not counted as the 90th day. Otherwise Saturdays, Sundays, and legal holidays are to be counted in computing the 90-day period.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to this office for the attention of IRA: 90D. The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the de-

ficiency or deficiencies, and will prevent the accumulation of interest, since the interest period terminates 30 days after receipt of the form, or on the date of assessment, or on the date of payment, whichever is earlier.

Very truly yours,

JOHN B. DUNLAP,
Commissioner,
By (Signed) R. C. CAKE
Internal Revenue Agent in Charge

Enclosures:
Statement
Form 1276
Agreement Form

MEC: nmh

STATEMENT

CLEVELAND
IRA: 90D

In re: Mr. Henry P. White and
Mrs. Nancy A. White, Husband and Wife
2688 Landon Road
Shaker Heights
Cleveland, Ohio

Tax Liability for the Taxable Year Ended December 31, 1948 and the Taxable Year Ended December 31, 1949

Income Tax

Year	*Deficiency*
1948	$ 1,088.51
1949	10,014.28
Total	$11,102.79

In making this determination of your income tax liability, careful consideration has been given to the report of examination dated May 10, 1951, to your protest dated September 20, 1951, and to the statements made at the conference held on October 18, 1951.

On March 19, 1951 you filed a claim for refund on Form 843 for the taxable year ended December 31, 1948 in the amount of $7,671.05 based on the contention that you made an "arithmetical error on page 2 of return" in the amount of $14,414.40 and you further contend that the amount of estimated tax as having been paid and shown on page 1 of the return was understated in the amount of $1,092.07.

Investigation discloses that both contentions are correct. However, another adjustment has been made resulting in a deficiency of income tax; therefore, your claim for refund of income tax will be disallowed.

If a petition to The Tax Court of the United States is filed against the deficiency proposed herein, the issues set forth in your claim for refund for the taxable year ended December 31, 1948 should be made a part of the petition to be considered by The Tax Court in any redetermination of your tax liability. If a petition is not filed, the claim for refund will be disallowed and official notice will be issued by registered mail in accordance with section 3772 of the Internal Revenue Code.

A copy of the statutory notice of deficiency, together with a copy of this statement, has been mailed to your representative, Mr. David H. Shook, Terminal Tower Building, Cleveland 13, Ohio, in accordance with the authority contained in the power of attorney executed by you and on file with this office.

ADJUSTMENTS TO NET INCOME

Taxable Year Ended December 31, 1948

Net income as disclosed by return	$46,192.72
Unallowable deductions and additional income:	
(a) Business loss	18,624.82
Total	$64,817.54
Nontaxable income and additional deductions:	
(b) Arithmetical error	14,414.40
Net income adjusted	$50,403.14

EXPLANATION OF ADJUSTMENTS

(a) Under Schedule C of your return for 1948 you claimed a deduction for expenses of $18,624.82 incurred in the operation of an alleged business of "Ordnance Engineer." It is held that such expenses were not ordinary and necessary expenses of carrying on a trade or business deductible under section 23(a)(1)(A) of the Internal Revenue Code, and furthermore, said amount is not deductible in accordance with section 24 of the Internal Revenue Code.

(b) On page 2 of your 1948 income tax return, you made an arithmetical error of $14,414.40 in reportable income. Net income is reduced $14,414.40 to correct the error made.

COMPUTATION OF TAX

Taxable Year Ended December 31, 1948

Alternative tax:	
Net income adjusted	$50,403.14
Less: Exemption	2,400.00
Net income subject to tentative tax	$48,003.14
One-half of net income	$24,001.57
Tentative tax on $24,001.57	$ 9,560.93
Less: Partially tax exempt interest	11.25
Balance of tentative tax	$ 9,549.68
Tax reduction: $68.00 plus 12% of $9,149.68	1,165.96
Partial tax on one-half of net income	$ 8,383.72
Total normal tax and surtax (2 x $8,383.72)	$16,767.44

Less: Income tax payments to a foreign country	$ 119.40	
Income tax paid at source on tax free covenant bond interest	39.62	159.02
Income tax liability		$16,608.42
Less: Tax paid on account of declaration of estimated tax	$11,092.07	
Tax assess on return	4,427.84	$15,519.91
Deficiency of income tax		$ 1,088.51

ADJUSTMENT TO NET INCOME

Taxable Year Ended December 31, 1949

Net income as disclosed by return	$60,675.33
Unallowable deductions and additional income:	
(b) Business loss	18,521.02
Net income adjusted	$79,196.35

EXPLANATION OF ADJUSTMENTS

(a) Under Schedule C of your return for 1949 you claimed a deduction for expenses of $18,521.02 incurred in the operation of an alleged business of "Ordnance Engineer." It is held that such expenses were not ordinary and necessary expenses of carrying on a trade or business deductible under section 23(a)(1)(A) of the Internal Revenue Code, and, furthermore, said amount is not deductible in accordance with section 24 of the Internal Revenue Code.

COMPUTATION OF TAX

Taxable Year Ended December 31, 1949

Alternative tax:

Net income adjusted		$79,196.35
Minus: Net capital gain		11,248.81
Ordinary net income		$67,947.54
Less: Exemption		2,400.00
Net income subject to tentative tax		$65,547.54
One-half of net income		32,773.77
Tentative tax on $32,773.77		$14,962.96
Tax reduction:		
$68.00 plus 12% of $14,562.96		1,815.56
Partial tax on one-half of net income		$13,147.40
Partial tax on total income (2 x $13,147.40)		$26,294.80
Plus 50% of net capital gain ($11,248.81)		5,624.40
Alternative tax		$31,919.20
Total normal tax and surtax		$31,919.20
Less: Income tax payments to a foreign country	$122.13	
Income tax paid at source on tax free covenant bond interest	175.03	297.16
Income tax liability		$31,622.04
Income tax liability disclosed by return		21,607.76
Deficiency of income tax		$10,014.28

ANSWER.

(Filed November 12, 1952.)

COMES NOW the Commissioner of Internal Revenue, by his attorney, CHARLES W. DAVIS, Chief Counsel, Bureau of Internal Revenue, and for answer to the petition filed herein, admits and denies, as follows:

1 and 2. Admits the allegations contained in paragraphs 1 and 2 of the petition.

3. Admits that the deficiencies as determined by the Commissioner are in income taxes for the calendar years 1948 and 1949 in the following amounts:

Year	*Deficiency*
1948	$ 1,088.51
1949	10,014.28

making a total of $11,102.79, all of which is in controversy; denies the remaining allegations contained in paragraph 3 of the petition.

4. (a) to (d), inclusive. Denies that, in the determination of the deficiency herein, the respondent erred in the manner and form as alleged in subparagraphs (a) to (d), inclusive, of paragraph 4 of the petition.

5. (a) and (b). Denies the allegations of fact contained in subparagraphs (a) and (b) of paragraph 5 of the petition.

5. (c). Admits the allegations of fact contained in subparagraph (c) of paragraph 5 of the petition.

5. (d) and (e). Denies the allegations of fact contained in subparagraphs (d) and (e) of paragraph 5 of the petition.

Denies generally each and every allegation contained in the petition not hereinbefore specifically admitted, qualified, or denied.

WHEREFORE, it is prayed that petitioners' appeal be denied and that the respondent's determination be in all respects approved.

CHARLES W. DAVIS,
Chief Counsel,
Bureau of Internal Revenue,
Counsel for Respondent.

Of Counsel:

THOS. F. CALLAHAN,
District Counsel,

JAMES F. KENNEDY, JR.,
Special Attorney,
Bureau of Internal Revenue.

PROCEEDINGS BEFORE THE TAX COURT OF THE UNITED STATES.

Municipal Court Building,
Room 8,
Cleveland, Ohio
November 11, 1953—10:30 a.m.

(Met pursuant to notice.)

BEFORE:

HONORABLE CLARENCE V. OPPER, *Judge.*

APPEARANCES:

WILLIAM PATRICK CLYNE, ESQ.,
NBC Building, Cleveland, Ohio, appearing for the Petitioners.

JAMES F. KENNEDY, JR., ESQ.,
1017 Euclid Building, Cleveland, Ohio,

(HONORABLE EARL HEILMAN,
Chief Counsel, Bureau of Internal Revenue), appearing for the Respondent.

(3) The Court: Docket No. 44257, Henry P. and Nancy A. White.

State your appearances for the record, please.

Mr. Clyne: William Patrick Clyne for the Petitioners.

Mr. Kennedy: James F. Kennedy, Jr., for the Respondent.

The Court: Before we go any further, I didn't ask you a few minutes ago, what is your estimate of the time in this case?

Mr. Clyne: Two and a half to three hours.

The Court: Does that include cross examination?

Mr. Kennedy: Yes, your Honor.

The Court: You say you have no witnesses?

Mr. Kennedy: I have no witnesses.

The Court: Proceed, please.

OPENING STATEMENT ON BEHALF OF THE PETITIONERS.

Mr. Clyne: If the Court please, Petitioner in this case, particularly Henry P. White, is a graduate engineer and licensed in Ohio and in Maryland and who since 1936 was operating a research laboratory in Cleveland in late years in Maryland.

The principal part of the engineering field that Mr. White's activities related to related to guns and ammunition (4) and kindred or associated engineering products. Mr. White holds himself out for use and hire to both Governmental Agencies and private industry and has served them both.

In addition to the personal service that he has rendered directly for hire to both industry and Government, he has published works that are the keystone of identification in ballistics. In the conduct of this business, he has a number of employees who aid and assist in the research and the performance of the services rendered to anyone who has a right to the information that his laboratory produces.

The issues involved in the case are simple. The same issue presents itself in both years. We believe and will prove that all of the expenses that have been disallowed

by the Commissioner are ordinary and necessary expenses and should have been allowed under the Revenue Act. The disallowance and the contention of the Government was that these were not expenses such as were contemplated by the Statute. I believe that the Government as well will agree that the mathematical amounts involved in the disallowance in both years are accurate and that they represent expenditures made by Petitioners in the conduct of their business during the years that are involved. This will simplify the proof, if the Court will permit us to treat the issue of usefulness and deductibility of these amounts both years as one issue.

The Court: I'm not sure I understand your suggestion. (5) Do you want the witnesses to testify at the same time about both years?

Mr. Clyne: Your Honor, the disallowance on the basis—the contention of the Government, turning it around in simple words, is that they have disallowed this on the basis that it was a hobby and not a useful business purpose. We contend that it is and has been and the reason for the disallowance that the Government disallowed these items as a deduction was the same reason in both years and we propose, if the court will permit us, to prove out our case as to the usefulness and business purpose of this laboratory on a broad basis, rather than particularize it for each year, because the same work was conducted by the laboratory in broad general terms in both years that are involved in this case.

The Court: Well, I'm afraid I still don't follow what it is that you are asking about; but is it a fact that that is something that will arise as the proceeding goes along?

Mr. Clyne: Yes, sir.

The Court: Rather than something I have to rule on now?

Mr. Clyne: Yes, your Honor.

The Court: Now, coming to your Assignments of Error, your Assignment of Error "c"—well, first of all, (6) Assignment of Error "b" determined the failing to

order a refund. Is that by way of stating the claim of overpayment?

Mr. Clyne: Yes, your Honor.

Mr. Kennedy: Your Honor, the Statutory Notice says that they are entitled to that over statement, because the deficiency was not refunded. The usual instructions in the Statutory Notice make it a part and include it, so I believe he was following the instructions. That has nothing to do with the issue of returns. It is just that the payment was held up because an ultimate deficiency was determined.

The Court: These taxes are for other years?

Mr. Clyne: It's one year.

Mr. Kennedy: It's an arithmetical mistake, the refund is based on.

The Court: What about the next one, the $1,092.07?

Mr. Kennedy: That again is the $1,092.07. The Statutory Notice indicates such: "You further contend that the amount of estimated tax having been paid as shown on Page 1 of th. return was under-stated in the amount of $1,092.07. Investigation discloses that both contentions are correct. However, another adjustment has been made resulting in a deficiency of income tax. Therefore, your claim for refund has been denied."

The Court: You say something was understated?

(7) Mr. Kennedy: Apparently on Page 1 of his income tax return, he understated the payments he made on the estimated tax. He actually paid more than that.

The Court: You mean the installments paid are greater than the income tax?

Mr. Kennedy: That is correct, your Honor.

The Court: I understand between you gentlemen there is no dispute as to Assignments of Error "b" and "c", that being conceded by the Respondent, as I understand.

Mr. Kennedy: That's correct, your Honor. They will be conceded by the Respondent. Assignments 4-b and 4-c are factually correct.

The Court: 4-b and 4-c, so that leaves only "a" and "d", which relate to the deductions that Mr. Clyne has been referring to.

Mr. Kennedy: That's correct, your Honor.
Mr. Clyne: That's right, your Honor.
The Court: That concludes your statement?
Mr. Clyne: Yes, your Honor.
The Court: Do you have anything?

OPENING STATEMENT ON BEHALF OF THE RESPONDENT.

Mr. Kennedy: I think, your Honor, Mr. Clyne has accurately stated what the issues are, except what the Government contends. We do not exactly contend that this man's operations are a hobby, nor that it does not serve a useful (8) purpose. We think that the evidence the Petitioner will put on will show it did serve a useful purpose. We do say, however, that the business was not operated for a profit and therefore the losses cannot be allowed; and secondly, that notwithstanding the first contention, the expenses were not ordinary and necessary to produce an income, the gross income which was reported for these years for these activities under Section 24, under which this latter contention is being made. It is covered in the Statutory Notice.

I think more argument would be better saved for the brief, however.

The Court: Well, it's a matter of getting the issues clarified, so both sides will know how to proceed with the case.

Proceed.

Mr. Clyne: Call Calvin Goddard.

Whereupon, CALVIN H. GODDARD called as a witness for and on behalf of the Petitioners, having been first duly sworn, was examined and testified as follows:

The Clerk: Have a seat, please, and state your name and address, please.

DIRECT EXAMINATION by Mr. Clyne.

(9) Q. Will you state your name, please? A. Calvin H. Goddard.

Q. And your address, please? A. 3533 Quebec Street, N. W., Washington, D. C.

Q. What is your present connection with the Government, Colonel? A. I am a Colonel presently commissioned in the Medical Corps in charge of the preparation of the history of the U. S. Medical Department in World War II.

Q. When was your association with the Army, when did it commence? A. I was commissioned a First Lieutenant in 1915, went on active duty in 1916.

Q. You are a graduate medic, are you not? A. Yes.

Q. When you went into the service in 1916, what service were you connected with? A. I was in the Medical Corps at that time.

Q. How many years did you stay in the Medical Corps, Doctor? A. Until 1920. I resigned in June, 1920.

Q. And immediately after that, what work did you do? A. I became a medical administrator. I was for some years assistant director of Johns Hopkins Hospital in Baltimore and of the Cornell Clinic in New York City.

(10) Q. Following that, what service did you have? A. Following that I resigned from Cornell and indulged a desire I had always had to go into experimental work in small arms.

Q. And where did you engage in that? A. I joined with three others to form what we designated the Bureau of Forensic Ballistics in New York City.

Q. What was the nature of the work you were attempting to do in that laboratory? A. We were attempting to develop instruments and techniques whereby it would be possible to identify positively a given bullet or empty cartridge case to the weapon that had fired it.

Q. How many years were you engaged in research with that? A. I did some research in it before I went to New York on my own about a year and while I was in Baltimore and then the three of us, the four of us worked together from 1924 to the end of 1926. Then I worked on alone after that.

Q. Did you devise such a method? A. We did.

Q. What was the method that you used that finally came into existence? A. Well, we applied an instrument which had long been known, called the comparison microscope. We applied this instrument (11) to the study of fired bullets and cartridge cases. That gave us immediately the means of making these identifications.

Q. And is that system used now in the world? A. Throughout the civilized world, yes.

Q. And that all came as a result of your research that you and your associates did in New York? A. Yes, sir.

Q. When was it first used, was it in the Valentine murders in Chicago? A. No, we had been using it since the spring of 1925. The Valentine murders were in February, 1929.

Q. And is that, for instance, the same method that is used by, let's say, the Federal Bureau of Investigation and all large and small police departments in the United States? A. It is.

Q. Would you tell us, if you could, please, after you had devised this method by which shells and bullets were identified, what return, if any, did you get from trade or business or Government agencies for your method? A. What return?

Q. Yes, in money. A. None.

Q. Now, following your period of research and the development and spreading of the use of this method that you had devised, (12) where did you next work? A. Well, as I said, we started applying this instrument in the spring of 1925 and scientific advance travels relatively slowly, so it was probably some time in 1927, I think, before Prosecutors began to become interested in employing me as a consultant on cases involving firearms and after a beginning had been made, the work increased very rapidly and this Valentine day affair in Chicago to which you have referred brought it so prominently in the public eye, that from that time on it was a complete success scientifically and police departments undertook to instruct specialists in using the comparison microscope and the other equipment

that goes with it and all major police departments now have arms identification laboratories throughout the world, so as I say, the Valentine day affair was the one that really put it on the map.

Q. Did you after that become associated with any school? A. Yes, a very wealthy man in Chicago who had been foreman of the Coroners Jury investigating the Valentine day massacre was so impressed by this new development in police procedure that he asked me if I would set up a laboratory in Chicago to render service without charge to all police agencies in the Chicago Area, service in any cases involving firearms, and that was to be his contribution to society, and I suggested that if he wanted to do that much, why not establish a complete (13) crime detection laboratory patterned on those which had been in existence overseas for generations.

He had never heard of such a thing, but he thought the idea was good and he sent me to Europe and I spent several months visiting the outstanding police laboratories and medical legal institutes in 13 West European Countries, and when I returned, based on the information I had brought together, he put up the money to establish the scientific crime detection laboratory of Chicago, first in affiliation with and then absorbed by Northwestern University of Chicago as a function of its Law Department.

Q. And did you have an assignment on the teaching staff, and if so, what were you on the teaching staff? A. From 1930 until my resignation some years later, I was professor of police science of the law faculty of North-Western University.

Q. Isn't it a fact that during the time you were a professor at Northwestern in that Division, that the lie detector that is commonly used in the United States was developed and perfected? A. In a measure; yes, sir. I engaged Leonarde Keeler, the developer of the lie detector, for my staff in the crime laboratory in the summer of 1930, and he was with me as long as I was there.

* * * * *

(16) By Mr. Clyne:

Q. Are you familiar with the nature of the work that is being done by the H. P. White Laboratory by Mr. White and his associates? A. I am familiar with the general nature of their operations, probably with not all of their activities.

Q. From your experience as it is identified with arms and ammunition, what is your opinion as to the need and necessity for a privately-operated laboratory in America today? A. I think there is a need for such a laboratory.

Q. Would you tell us why? A. Because most of the advance in small arms research over the years with which I have been familiar with it has resulted from the individual efforts, of you might say, dedicated persons who became convinced that they had a new and good idea, and that it should be developed, ordinarily from a patriotic standpoint, for the benefit of the nation. But in periods between wars nations are not especially interested in ordnance development, at least they have not been in the past and these individuals receive very little encouragement. They are not offered the facilities of ordnance establishments for testing and improving design. The commercial manufacturers are ordinarily not interested, unless the design involves something which can be made more cheaply than of current models, or something which they feel they might take (17) over and sell to a Government.

So, the individual is left to his own resources to carry out all the engineering steps in connection with the development of his ideas and unless his resources are very, very great, he is not able to carry the idea forward.

Given an organization, such as the White Laboratory, a man with modest resources aided by the engineering know-how of White and his associates could readily perfect something that might be of extreme value nationally or, commercially.

So, I feel that the laboratory does fill a spot which did not previously exist.

Q. Do I understand you correctly that were I to manufacture a gun or a shell and wished to avail myself of the

services of the engineering departments of the recognized large or small manufacturer of arms or munitions, that they do not aid or assist private individuals, unless it had some gain to themselves beyond just being compensated for their time? A. That's my general reaction to the experiences I have had or experiences others have had who have been interested in ordnance development.

Q. Isn't it a fact that most of the inventive genius of Americans who have invented arms and munitions who were not part of the big group, that they have been almost compelled to sell their inventions to foreign nations because of the (18) unwillingness of Americans to absorb them? A. Many such instances exist, yes.

Q. Now, in the current market, I am talking about as of now, in the development in the last five or six years, has there been any activity from a group known as Self-Loaders? A. Well, you mean by that people who already load their own ammunition?

Q. That is correct. A. Those people have been active for three-quarters of a century, but they have been unusually active in the past few years by reason of the prohibitive, almost prohibitive cost of ammunition, the small arms ammunition if you buy it over the counter these days. A man that is not wealthy can't afford to keep in practice.

Q. Coming back to the time you were professor at Northwestern University in charge of that division that related to crime detection, did you have a library of guns? A. We had about 2,000, as I recall.

Q. Did that represent one of each type of gun, or more than one in each classification? A. We tried to get one of every make and model and calibre in every length of barrel in which it was made.

Q. Did you also have shells? A. We had thousands of loaded cartridges, empty primed cartridge cases and the separate bullets as a reference library.

(19) Q. Is that a necessary adjunct to rendering a service such as you were doing at Northwestern or White does? A. It's very definitely necessary for crime detection

and if White wishes to render a very complete service to persons interested in arms and ammunition, the larger reference collection he can maintain, the more complete the service he can offer.

Q. The individual user, you have stated, has need for the laboratory techniques of organizations such as Mr. White's on his re-loading problems, am I to understand that that is it? A. If the independent user of firearms is willing to stay within the prescribed narrow limits laid down by the loading companies as a proper field within which to carry out his re-loading activities, he doesn't need the services of a company like White. However, if he feels that he can develop loads that are—with his weapon and with the cartridge cases adapted to that weapon, loads of greater velocity or energy or accuracy, then he has to invoke the aid of an organization such as White, unless he has all the elaborate equipment which they possess and very few independent loaders have such equipment.

Q. So is that group of people that are experimenting with loads for accuracy or other reasons, is that group increasing today, to your knowledge? (20) A. Well, the National Rifle Association has something over 300,000 members, and I don't know what proportion, but a very considerable proportion of those re-load their own ammunition, in evidence of which is the number of re-loading tools on the market which, within my period of knowledge increased from about two makes to 20 or 30 makes, probably.

Q. When did that increase come to your knowledge? A. Since World War I and more intensively since World War II.

Mr. Clyne: Thank you. Your witness, Mr. Kennedy.

* * * * *

(33)

Whereupon, E. W. KRONBACH, called as a witness for and on behalf of the Petitioners, having been first duly sworn, was examined and testified as follows:

The Clerk: Have a seat and state your name and address.

The Witness: E. W. Kronbach.

The Clerk: Your home address, please?

The Witness: 2016 Rossmoor Road, Cleveland Heights.

DIRECT EXAMINATION by Mr. Clyne.

Q. What is your business connection, Mr. Kronbach? A. The Van Dorn Iron Works Company.

Q. What is your particular status in the Van Dorn Company? A. Metallurgical work.

Q. Have you had any business dealings with the H. P. White Laboratories during the years you have been at Van Dorn? A. Yes, we have.

Q. Would you tell the court just exactly when and what it was, please? A. I believe it was started the latter part of 1940 or the early part of 1941. It was at a time when our company started armor plate development, and the production of armor (34) plate. During that period it was becoming extremely difficult to obtain the normal materials that we needed for our production, so I believe it was at the suggestion of the local ordnance department at that time that they suggested that armor plate might be something that might fit into our particular type of fabrication and our equipment, so we decided to go into the armor plate business to make armor plate for all the various armed forces.

As a matter of fact, we received from the Government an educational order to make up three complete tanks. That, of course, was done with the idea in mind to educate our organization and build up an organization and also gain the experience in the fabrication as well as the heat treatment and actual production of armor.

Well, during 1941, the early part of 1941, there was quite a demand for other types of armor plates, such as for aircraft and gun shells and light armor that called at that time not only for our own armed forces, but for orders placed here by foreign governments.

The result was we endeavored to make armor for these various organizations and found that we more or less had to start from scratch. There was very little knowledge and very little you could read about it. We more or less had to develop this knowledge and this experience ourselves.

One of the requisites in the production of armor was, (35) of course, that the armor was always made under very rigid specifications for the Army or Navy or Air Corps, as the case may be, and the final test before a heat of steel could be accepted and before it could be fabricated had to be made at the Government proving grounds and those were ballistics tests primarily. Each plate has a different thickness of platings, you have different specifications required of different types of projectiles, and you had to hold certain projectiles at various speeds, each projectile carrying its own range. We made armor during the war, for instance, three-sixteenths inch thick up to two inches thick under probably 15 to 20 different specifications. Each one was different. It required different types of steel, different chemistries of steel, so the first thing we found when we started the development of this armor plate under the first specification we worked under was we made up what from our point of view as metallurgists seemed to be plates of the proper hardness to withstand the particular projectiles which this plate had to resist. We would send those down to the proving grounds, and a week or so later we would get a report they were right or wrong, but it took a great deal of time and we realized that we had to be present during the time these plates were tested, because it was not only a question whether they would withstand these particular projectiles, but we learned by looking at the type of plate, the hole, whether the projectile (36) went through the plate, whether it was a clean hole or jagged hole, whether those things were important in working out the proper metallurgical processes to get the most possible use out of the plate.

So as the demand for the armor plate increased and we had heat after heat coming in, we had difficulty in getting and submitting plates to the proving grounds on an

experimental basis, because they were naturally busy, they were working three shifts a day and they could accept only so many plates on a purely experimental basis. Their main function was to approve plates by their ballistics tests or to approve heats by their tests; so we could only do a certain amount of that and as we had to use so many different types of analyses, we realized that we were simply tied and that we were losing time, unless we found some way of testing these plates ourselves, at least the experimental plates, so as to expedite our experience and our knowledge in the development of the particular processes that had to be used.

So we started looking around and trying to find out whether there was any possible way we could obtain the necessary equipment that would allow us on our own range and we put in our own testing range, a full-size range, 300 yards and we had to find the equipment that would enable us to test or to learn the actual speed of the projectile as it hit the plate. That was the basis of the final test.

(37) Now, if we could do that, it would save us all this time shipping back and forth and sending our men back and forth. We could treat a plate, a heat treat in five minutes like that on the range.

That was when we learned about the H. P. White Company and I remember the first time we saw them, we went over to their laboratory on East 93rd and Euclid Avenue, somewhere around there, and they had even then a small range and they had, I recall, methods of checking the speed of the projectile. That's exactly what we wanted and we talked to them whether they could do something for us in working out some sort of apparatus that would enable us to determine the speed of these projectiles as we shot them at the armor plate. They said they could, so we immediately contacted them, made a contract with them, so that they would supply the equipment, which they did very promptly. As a matter of fact, they came over and installed it and spent a great deal of time over it helping us work out the actual procedure and methods and calculation and so forth, so that we would get the actual results of their tests.

After we put this in, we saved I don't know how much time, but we saved time and time again, because we could get a heat of steel in. We could make a half a dozen experimental plates, using different heat treatments inside of 24 hours after the heat treatment was completed, we could test these (38) plates. We knew the best procedure for that particular chemistry of that particular type of steel we were using for that plate, and we could make up immediately the final plates for the proving grounds, and that way we could start production.

Not only that, but at that particular time in 1941 and 1942, there was a demand for armor plate by all the armed forces which was tremendous. As a matter of fact, we were working three 8-hour shifts around the clock, Saturdays, Sundays, and every holiday. By having this particular equipment we were not only able to save all this time and to use our own organization in the best heat treatment of these various steels, but as time progressed the shortage of alloys became a very serious problem in the armor plate production. We were constantly told every so often we could only use so much metal or so much chrome or so much of this or so much of that. It meant experimental heats time after time and we had to develop the best heat treatment so as to still meet these specifications.

We made dozens and dozens of experimental plates from these various heats that would be submitted by the steel companies trying to work out a satisfactory heat treatment that would enable us to use these lower alloys of steel for the specifications of the Army, Navy, and Air Corps. That's where we saved so much time.

(39) As a matter of fact, we couldn't have gotten along without some instrument, as I understand, that would help us meet the right requirements.

Q. Would you tell me who recommended the White Company to you at that time? A. I believe we learned about it through one of our engineers who had met Mr. White and some of his associates and at the time we brought this up, I think he is the one that told us we could do it and, as a matter of fact, he organized a little group of

three or four of us to go over and see the laboratory, which they had at that time.

Q. Now, you have an engineering group in your organization? A. Yes.

Q. How many in your organization are graduate licensed engineers? A. I suppose maybe 35.

Q. Do they do experimental work in connection with your operations at Van Dorn? A. Yes.

Q. Does the Engineering Department group of Engineers together, does that organization make a profit of itself? A. I don't suppose it does, no. We have got to depend on what the results will be after we develop it.

Mr. Clyne: Your witness.

* * * * *

(41)

Whereupon, ARTHUR E. HART, called as a witness for and on behalf of the Petitioners, having been first duly sworn, was examined and testified as follows:

The Clerk: Have a seat and state your name and address, please.

The Witness: Arthur E. Hart, 2140 Rockside Road, Seven Hills Village.

The Court: Will you instruct the witness this isn't a private conversation between him and the reporter.

DIRECT EXAMINATION by Mr. Clyne.

Q. Your name is Arthur E. Hart, is it not? A. That's right.

Q. And your home address is what? A. 2140 Rockside Road, Seven Hills Village.

Q. What is your business, Mr. Hart? A. I operate the Hart Arms Company.

Q. That is located in the City of Cleveland? A. 1201 St. Clair.

Q. How long have you been engaged in that business? A. Thirty-three years.

Q. And prior to that time, were you identified with arms or ammunition? A. Well, I shot on several state teams, but up to that (42) time I wasn't engaged in the business.

Q. And your present business is the sale of guns and ammunition as two of your products to the general public, is it not? A. Yes, sir.

Q. During the time that you have been engaged in the business, have you had an occasion either to use the H. P. White Laboratories yourself or recommend its use to others? A. I recommended their use to others, especially the hand loaders.

* * * * *

(46)

HARLEY BENETHUM, called as a witness for and on behalf of the Petitioners, having been first duly sworn, was examined and testified as follows:

The Clerk: Have a seat and state your name and address, please.

The Witness: Harley Benethum, 3400 Lee Road, Shaker Heights.

DIRECT EXAMINATION by Mr. Clyne.

Q. What is your occupation? A. Chief of Police, Shaker Heights Police Department.

Q. In the course of your service with the Police Department, have you made use of the services of the H. P. White and his associates and their laboratory? A. I have.

Q. Would you tell the court just what use you have made of it over the period of years? A. I think it was in 1947 that I made use of their services. I was a lieutenant at that time and the Fraternal Order of Police Lodge, Shaker Heights Police Department, purchased a hand loading device. Our purpose in purchasing it was to reload cartridges for use on our pistol range for target practice only. During one of our target shoots, one of the police

guns exploded in the hands of one of the officers during (47) target practice and I don't recall at this moment how we learned of the H. P. White Company, but at any rate we went to the White Company for information as to whether it might have been a defective gun or defective ammunition. We were new in the game and didn't know too much about hand loading and didn't know where to attach the blame for this gun having exploded and we went to them for advice.

Q. Do you have a ballistics laboratory in Shaker Heights? A. We do not.

Q. Does the Cleveland Police Department do the ballistic examination? A. Yes, they do. In criminal cases, you mean?

Q. Yes. A. Yes.

Q. Do you know from your own experience what equipment and use, whether or not they make use there of the catalogue of cartridge manufacturers and base markings that Mr. White put out? A. I know at one time that Inspector Cowles had such a book, the book you speak of.

Q. Have you had any other, was any other further service rendered by White to you or your organization during the years? A. Yes, we went to the White Company for information with respect to the type of powder and kind of powder and (48) quantity of powder that we should use in hand reloading.

Mr. Clyne: Thank you. Your witness.

CROSS EXAMINATION by Mr. Kennedy.

Q. What did the H. P. White Company charge you for the first service they performed for you in determining what was— A. I wasn't Chief at that time and I can't answer that question. I don't know. I don't even know whether they did charge. If they did, I don't know. I wasn't Chief at that time and have no experience.

Q. Do you know of any charges they made for subsequent services performed? A. No, I do not. In fact, there was no subsequent service, to my knowledge.

Mr. Kennedy: Thank you. That's all the questions.

Mr. Clyne: I have one question, Chief.

RE-DIRECT EXAMINATION by Mr. Clyne.

Q. Was the service the Whites rendered to you, such as you described, the loading and ammunition that you did use by hand loaders on your hand loaders, was that of service to you and your organization? A. Very important, very important, yes.

Mr. Clyne: That's all.

(49) Mr. Kennedy: Thank you. I have no questions.

(Witness excused.)

Mr. Clyne: Mr. Cook.

Whereupon, T. DICKERSON COOK, called as a witness for and on behalf of the Petitioners, having been first duly sworn, was examined and testified as follows:

The Clerk: Have a seat, sir, and state your name and address, please.

The Witness: My name is T. Dickerson Cook. My address is 2424 Park Place, Evanston, Illinois.

DIRECT EXAMINATION by Mr. Clyne.

Q. Mr. Cook, what is your business connection? A. I am director of the Institute of Applied Science in Chicago.

Q. What is the business of the Institute of Applied Science? A. The Institute of Applied Science is a home study school teaching identification and investigation work.

Q. What work do your graduates do? A. Our graduates go into identification bureaus and law enforcement agencies and approximately a third of all such (50) identification bureaus in this country are headed by our former students. We also have graduates working in over 800 identification bureaus in this country. Many of them are not heads of their departments, but they are employed in those bureaus.

Q. Now, have you had need or use for the service of the H. P. White Laboratory during the time you have been director of your institution? A. I have.

Q. What work do they do for you? A. We engaged H. P. White Laboratories approximately 18 months ago to re-write our instruction lessons on firearms identification.

Q. And that is currently being or about to be used by new students in your courses? A. That is correct.

Q. And may I ask on what basis you determined to use H. P. White and his associates to do that? A. There were three reasons why we engaged the H. P. White Laboratories to do this editorial work for us. The first reason was that we knew they had the technical knowledge requisite to preparing such text material.

The second basis was that we knew from the books that they had published, the professional articles that they had written, that they had the editorial skill to write the text (51) material in the method that we wanted it prepared.

The third reason for engaging them was that we knew that the H. P. White Laboratory had the requisite photographic material to prepare the illustrations that we wanted included in these lessons.

Q. Are your students or graduates limited to the United States? A. They are not. We have students and graduates in over 50 countries.

Q. Am I to understand that the courses that you prepare and use are printed in more than one language? A. No, sir; they are printed in English only.

Q. When you made your contact with the White organization to re-write your work on guns and ammunition identification, was price the factor that determined the selection of them? A. Price was a factor, yes, in this respect; that we paid the H. P. White Laboratory several times more for preparing this lesson material than we had ever paid any previous writers.

Mr. Clyne: Your witness, Mr. Kennedy.

Mr. Kennedy: No questions.

(Witness excused.)

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(52)

Whereupon, HENRY P. WHITE, Petitioner herein, having been first duly sworn, was examined and testified as follows:

The Clerk: Have a seat, sir, and state your name and address, please.

The Witness: Henry P. White, Joppa, Maryland.

DIRECT EXAMINATION by Mr. Clyne.

Q. Mr. White—and for the court's information, Mr. White's hearing is not always good and if I do have to speak loudly, you will forgive me.

You gave your address as Maryland, Mr. White. How long have you been living in Maryland? A. I have been living in Maryland for the past year and a half, sir.

Q. Prior to that time you were a resident of Cleveland? A. Yes, sir.

Q. At the present time is your laboratory in Maryland? A. Yes, sir.

Mr. Clyne: Mark this for identification, please.

The Clerk: Marked for identification, Exhibit 1.

(The document above-referred to was marked Petitioners' Exhibit 1.)

Q. I am handing you herewith that which has been marked Petitioners' Exhibit 1, and ask you if you will tell me what it (53) is, if you will, please? A. That is the establishment of the H. P. White Laboratory in Maryland.

Q. Now, geographically, where is it located with reference to your residence, how many miles away? A. Approximately 11 miles northeast of my home.

Q. Now, during the time that you had your laboratory in Cleveland, it occupied a portion of a piece of prop-

erty that you personally owned, did it not? A. That is right, sir.

Q. And in what respect did it differ from the installation that is now at Bel Air, I mean, was the installation at Bel Air, larger or smaller than the other? A. This installation is much larger, sir.

Q. What was the reason for changing the scene of your operations from Cleveland to Bel Air, Maryland? A. The physical confines of the Cleveland, Ohio, laboratory made it almost impossible for us to embrace certain types of work which we wanted to do research in. The new laboratory in Maryland is located centrally along the general bulk users of our particular services; namely, we are not too far from Washington, not too far from the New York-New England arms manufacturing districts, and we also are relatively close to several Army and Navy proving grounds.

Q. You have a larger range, indoor range in Bel Air, (54) than you had here, do you not? A. Yes, sir. We have had only a 25-foot range here in Cleveland. We have a 50-yard range in Maryland.

Q. You also have an outdoor range, do you not? A. Yes, sir; we have a 400 meter range in Bel Air in the Maryland establishment, where we had no range at all for doing outside work, longer range work.

Q. Mr. White, you are a graduate of Cornell with a degree in engineering, are you not? A. Yes, sir.

Q. And you are a licensed mechanical engineer in Ohio as well as in Maryland, are you not? A. Yes, sir.

Q. And does the work that your laboratory does require the skills of an engineer? A. Yes, sir.

Q. Have you in the course of your service as a consulting engineer done work for the United States Government in any department? A. Yes, sir.

Q. Is it a fact that you have now a contract with the Navy? A. Yes, sir.

Q. Have you done work for the Treasury Department? A. Yes, sir.

(55) Q. What work did you do for the Treasury Department? A. We were considered in the Cleveland area as the most competent people to evaluate—I was going to say subversives, that is not the word I mean, illegal weapons that had been seized, such as for instance I remember one case of a Japanese machine gun somebody brought home for a war souvenir that had been seized, and, of course, it had to be evaluated, and we were the people to do it.

Mr. Clyne: Would you mark this?

The Clerk: Marked for identification Exhibit 2.

(The document above-referred to was marked Petitioners' Exhibit 2.)

* * * * *

(56) Q. I am handing you herewith that which has been marked Petitioners' Exhibit No. 2, and ask you whether or not you received such a letter from the Treasury Department? A. We did.

Q. In the course of your work at the laboratory, do you do work for organizations known as the National Rifle Association? A. Yes, sir.

Q. Do you do work for private individuals? A. Yes, sir.

Q. As well as organizations? A. Yes, sir.

Q. Does your laboratory have regular hours during which it operates and the employees report? A. It very definitely does, sir.

Q. Do the employees—what hours does the laboratory (57) work? A. We work from eight o'clock in the morning until 4:30 in the afternoon, normally speaking.

Q. Do you keep track of the hours that each and every employee works? A. We do, sir, and we have a timecard system.

Q. Do you have a cost system that puts the cost of their time to each and every project? A. Yes, sir.

Q. And that cost and that time is charged to customers? A. Where it is applicable; yes, sir.

Q. Now, in addition to the service that you render engineeringwise to hand loaders, what other services do you render to the public at your laboratory in Washington, or in Maryland, or have you rendered here? A. We have always been considered to have the facilities necessary to carry on investigations which have to do with firearms. Generally speaking, we do not take criminal cases. However, we do take civil cases and we have had a few of them, not a great many, but the ones we have, have been very conclusive and I can safely say that I am sure that everybody was very satisfied with our services and the way in which we conducted our investigations.

Q. In the course of your work at the laboratory, have you done work relative to speed photography? (58) A. Yes, sir; we have. In the past year we have obtained the necessary high-speed photographic equipment that is so necessary for the analysis of certain types of bullet motion and not only bullet motion, but also certain types of high-speed machine motion, such as, well, if I might give an example, a shuttle loom to meet gears operating at relatively high rotating speeds.

We have a motion picture camera there that takes, well, I believe the high-speed runs close to 6,000 frames a second. In other words, we can analyze what is happening when that machine is in operation in two different ways to appraise something; one, to look at the thing when it is not moving, and the other when it is not under load or under power, and we are planning to exploit that in the industries in the area in which we are operating at the present time, give them a packaged unit that could really be sold on the basis that we will analyze a certain particularly troublesome problem that they have, they not having the know-how and being able to use this equipment can, as I say, obtain the service and do the job for them.

We also have a microflash unit we use almost entirely for this type of projectile problems. A microflash is a very high-speed photo flash light and a microflash is one

millionth of a microsecond, actually, and our particular light is capable of going down to two microseconds. You can see (59) how you could stop the motion of a very high-speed projectile down to the extent you would be able to capture it out and analyze it from a photographic plate.

Q. Now, am I to understand that the acquisition of this photographic equipment in itself had to be supplemented with the engineering skill and know-how that was developed in the laboratory during the last year or a year and a half? A. Yes, sir; and in some of the preceding years. We all crawl before we walk, and sometimes it takes longer to learn one thing. You can't say that you learn something in a year and a half that perhaps is dependent upon something that you learned five years prior to that time, either through constant use or by going to some school or through some other experiences you might have.

Q. Now, the work that the employees and yourself have done, so far as the establishment of a library, whether the library would be considered to include guns, shells, bullets, reference material and data of all kinds which you use, has much time in the past been used to catalogue that equipment for its use to the consumer?

I'm talking about the client or the customer that seeks and gains your service. A. It has. The actual hard work of garnering our sections from different pieces of source material, cataloging, the codification, the classification of all these items has (60) taken a tremendous long time in order to be what we consider of salable commodity, something we can say we know a little bit about, cartridges and so on, and we have them catalogued. We've got to have something to sell him before he comes. We have done that by keeping our name before the public in the publication of articles and books.

Q. Now, speaking about the books you prepared, at one time did your organization prepare a catalogue of cartridge manufacturers and base markings? A. Yes, sir.

Q. Was that sold to the general public? A. No, sir.

Q. Who was it sold to? A. It was primarily sold to the Armed Forces, to the law enforcement agencies, the peace agencies, and I believe, I've forgotten exactly, there were very few of those printed; as a matter of fact, a relative few, I should say, probably not more than six or eight of them ever got into private hands.

Q. Did the United States Government purchase them? A. Yes.

Q. Who in the Government purchased them? A. The Federal Bureau of Investigation and the Army and I would have to look at my records for the rest of them.

Q. Now, in the course of the years following the war, (61) has the request for services made upon your organization by hand loaders increased? A. Yes, sir.

Q. Has the request for your services, so far as your engineering opinion as to guns and ammunition, increased so far as Governmental Agencies are concerned? A. Yes, sir.

Q. You are presently carrying out a contract with the United States Government now? A. Yes, sir.

Q. And that is on a cost plus basis, is it not? A. Yes. Most developmental contracts are carried on that basis at the present time, because no one can accurately foresee the trend of research or the development. It's not exactly what you would say—you can't make up research and development as a batch apart, say a hundred bearings or something like that.

Q. Have you had any conversations with anybody relating to the purchase or sale of the H. P. White Company? A. Yes, sir; I have.

Q. Who? A. I had conversations prior to my coming to Cleveland with General Hatcher of the National Rifle Association.

* * * * *

(62) Mr. Clyne: If the Court please, I will now offer Exhibit 1 in evidence, that is the photograph.

The Court: That is this one?

Mr. Clyne: Yes, this is a copy.

Mr. Kennedy: Respondent has no objection to Exhibit No. 1.

The Court: Be received and marked in evidence.

(The document above-referred to was received in evidence and marked Petitioners' Exhibit No. 1.)

Mr. Clyne: I now offer Exhibit No. 2.

Mr. Kennedy: Respondent has no objection to Exhibit No. 2.

Mr. Clyne: And I ask leave of the Court to substitute copies.

The Court: But you are offering it as a photostat, (63) is that correct?

Mr. Clyne: Yes, your Honor.

The Court: That has not been marked for identification?

Mr. Clyne: No, your Honor.

The Court: The photostat will be received and marked for identification.

The Clerk: Exhibit 2.

(The document above-referred to was received in evidence and marked Petitioners' Exhibit No. 2.)

Mr. Clyne: If the Court please, I know that there is material to be offered on this letter in which counsel will object. May I submit it to the Court?

The Court: Are you offering this?

Mr. Clyne: I am going to offer this in evidence as proof of the standing offer to purchase the H. P. White Laboratory.

The Court: Which paragraph is it, you say—

Mr. Clyne: I say it's toward the end of the letter. I have only read it once, but it's toward the end of the letter.

The Court: I'll sustain the objection.

Q. Have you had conversations with the National Rifle Association relative to a more extensive use of your laboratory to supplement the service that they supply their members? A. Yes, sir.

(64) Q. And would that require additional help and service? A. We do not anticipate that at the present time.

If I may explain further, I have been approached to perhaps facilitate their starting a service to their members, and to the buying public very similar to the Good Housekeeping Seal of Approval on certain guns and ammunition and closely allied subjects; in other words, an NRA seal of approval. Naturally, for such a seal to be given to a product, it should be tested under certain recognized and minimum standards in order that they could feel that they were approving something. It would be done through the normal research, customer research angle, such as random buying and that sort of thing, so that it would be fair and impartial.

We say we are the only people in the United States that have a laboratory like this having to do with firearms that are not associated directly with one of the arms or munitions manufacturers and consequently a natural confidence should fall to an independent testing laboratory such as we maintain.

We also have the confidence of the National Rifle Association behind us and we have been building this up for a number of years and it appears that within a very short time this thing is going to come to a culmination, the fruition of all we have been working for in this particular (65) field.

Q. Do you know, can you give us an opinion as of now whether or not the operation of the laboratory during the year 1953 would be in black or red or whether you made a profit? A. We have made considerably more money than we have made in any other year so far. I do not know whether we will be in the black this year, but we have every confidence that we will be able to operate in the black next year.

Q. Percentagewise, if you can tell us, how much of your income increased this year over last year, as of now? A. I would have to check my figures, but I believe we are doing twice as much business as we were doing last year.

Q. Is the fact that you are doing twice as much business due partially to the scope of the fact that your laboratory operates in Bel Air as distinguished from your laboratory business here? A. Oh, it definitely is. There are con-

tracts we have been able to take we could not have accepted in the City of Cleveland.

Q. One more question. Can you tell me, Mr. White, approximately how much time of your own do you spend on research at the laboratory as distinguished from the time you spend in the management of your own affairs? (66) A. I should say I spend 90 per cent of my time on laboratory work.

Q. When you started this H. P. White Laboratory, was it your intention then to sell your services to the public? A. Yes, sir, it definitely was.

Q. Did you consult with other potential users whether or not there was a use that you could make a profit out of prior to the time you went in? A. I inquired, seriously considered this very important step to me of establishing this laboratory. I canvassed the field and some of the people that I considered would know something about that field to give me a little insight into what business might be expected.

Q. And who were they that you talked with? A. Well, I talked to Inspector Cowles down here on the Police Station. He is quite prominent as a criminologist here in town. He was in charge of the so-called Crime Lab down there and he has a fund of knowledge on this gun identification work. It was only until, oh, the last ten years that a great deal had been spread out as far as the identification work was concerned. At one time he was actually, well, not having to, but, of course, he was helping out in civil cases of gun identification. He knew the field. So I discussed it with him. The other person I discussed it with is now deceased, Sergeant Harry Butts of the Metropolitan Police (67) Department in New York City. He had been in the game a number of years and he brought to my attention some of the facets of the identification work that needed an awful lot of work done on them. The classification of bullets was for the most part done by one system or another. Sometimes there weren't even two common names to a cartridge or a gun. I could see there that there was a possibility of bringing all this stuff together, throw-

ing out the bad, keeping the good and doing something with it.

Then there was another gentleman I talked to who is right in this room at the present time, Colonel Goddard, whom you heard before me. I made his acquaintance and we were just talking it over last night how long we had actually known each other. I believe it was prior to the time he went to Chicago, but I can't exactly remember, but people interested in similar fields always gravitate together.

I believe I called him up one afternoon I had free in Washington and made a point to go out and meet him and discuss some of our mutual problems in the field involved. It was people like that, I have talked to Hart of the Hart Arms Company who you heard here. Of course, I have known him since I was a boy. I talked to him about this possibility of setting up a laboratory, a facility which would be doing a number of different operations, not only criminal investigation, but this technical testing for reloading, the proving of weapons (68) for the development of weapons, to take civil cases, and as the ideas progressed, why we were branching out further.

Does that answer your question, sir?

Q. Yes. Now, was it your intent when you went into this to make a profit? A. Yes, sir.

Q. During the years that intervened between 1936 and now, some of those years you were in the armed services, were you? A. Yes.

Q. How many? A. I was in the armed services for almost four years.

Q. During that time, did your laboratory continue to function and work, did you maintain your staff of employees during that time? A. Our staff of employees was very, very small. It limped along, our laboratory did. It was a question of my being, as every officer is, on 24-hour duty with the Army at the Aberdeen Proving Ground. Mr. Munhall, my assistant manager of the company, carried on with about one girl and an assistant in the laboratory.

Mr. Clyne: Thank you, that's all.

* * * * *

(70) Afternoon Session (2 o'clock, p.m.)

The Court: Proceed, please.

The Clerk: Marked for identification Exhibits 4 and 5.

(The documents above-referred to were marked Petitioners' Exhibits Nos. 4 and 5.)

By Mr. Clyne:

Q. I am handing you herewith that which has been marked Petitioners' Exhibit 4, and ask you to state if you know what that is? A. This is the income tax return for the year 1948.

Q. I am handing you herewith that which has been marked Petitioners' Exhibit 5, and ask you to state if you know what that is? A. That is my income tax return for the year 1949.

Q. You filed a joint return, yourself and your wife, for those years? A. Yes, sir.

Mr. Clyne: May I offer them in evidence at this time, your Honor?

Mr. Kennedy: No objection.

The Court: They will be received and marked in evidence, two exhibits.

(The documents above-referred to were received in evidence and marked Petitioners' Exhibits Nos. 4 and 5.)

(71) Mr. Kennedy: Your Honor, may I request to have them replaced with photostats.

The Clerk: Exhibits 4 and 5 admitted in evidence.

CROSS EXAMINATION by Mr. Kennedy.

Q. Mr. White, were you born in Cleveland? A. Yes, sir; I was.

Q. What year was that? A. 1909.

Q. And then I understand you testified you went to, was it Cornell? A. I did go to Cornell, sir.

Q. Of what university did you graduate? A. I graduated from Cornell University.

Q. Oh, I see. What year was that you graduated? A. I graduated in 1934.

Q. What did you do when you got out of college, right after you got out of college? A. I sold Ford automobiles.

Q. Was that your sole source of your income at that time? A. Sir?

Q. Was that the sole source of your income? A. No, sir; it was not.

Q. Would you mind stating what other income you had in (72) 1934? A. Yes, I received assistance from my family, because back in those days, of course, of the National Recovery Act, I was working at a minimum wage of $17.50 a week. I was married and I did require further assistance.

Mr. Kennedy: Excuse me a minute, Mr. White.

Your Honor, with those exhibits there is some extraneous material which I will not need photostated. I believe I hadn't removed them as yet. I think those were the revenue agent's report or something like that.

The Court: Well, I think the record ought to be clarified on that. They were offered and received as they are here.

Mr. Kennedy: I don't mind that they go in that way. I thought maybe Mr. Clyne may have some objection.

Mr. Clyne: Counsel and I agreed on them prior to the time they were offered and I am confident that they won't be—

The Court: Well, in order to avoid any misunderstanding, I think they ought to be removed in advance. There ought to be some statement on the record of what should be marked.

Mr. Kennedy: I will make the statement on the record that Exhibits 4 and 5 and the photostats which will replace Exhibits 4 and 5 will consist of the original income tax returns for 1948 and 1949 by the Petitioners and all attachments (73) that were filed with the returns.

The Court: Does that identify it sufficiently?

Mr. Kennedy: I think so, your Honor.

The Court: Very well.

Q. Mr. White, you were stating that you received assistance from the family after you got out of Cornell University? A. Yes, sir; I had a very meager personal investment return.

Q. I see. What did you do next after selling Ford automobiles in 1934? A. I was employed by the Central National Bank of the City of Cleveland.

Q. That was in 1935? A. That was prior—that was, I believe, no, sir—yes, sir; it was just the beginning of 1935, I believe it was March 4th.

Q. Did you have any outside income of your own during that period, that is, exclusive of any support you may have received from the family? A. Only that which I had when I left college. I don't recall the exact amount, but it was a very, very meager amount. I don't imagine it amounted to more than $300 or $400 a year.

Q. In 1937, what did you do? A. In 1937 I was—what did I do?

(74) Q. Yes, what was your employment in 1937? A. In 1937, sir, I had already established my laboratory and was giving full time to that and the management of my affairs.

Q. Did you have any outside income during that year? A. Yes, sir; I did. I was the recipient under a trusteeship of my late grandmother.

Q. Would you state what the principal amount of the trust fund was? A. Well, I would have to consult my records. It was considerable, however.

Q. Would two million dollars be approximately the sum? A. Well, I would have to consult my records on it. Frankly, you see, I was just the recipient under a trust at that particular time and did not have complete control of it or anything.

Q. Did you receive all of the income from this trust? A. No, sir; I did not. I only received half of it.

Q. Half the income? A. Yes, sir.

Q. Who received the other half? A. It was held in trust.

Q. For yourself? A. It was held in trust for me until I should be 40 years of age.

(75) Q. Oh, I see, but you couldn't state whether two million dollars was the principal amount of this trust or not? A. Well, the exact figures escape me now, because it was depreciated so much by the inheritance tax and so on.

Q. Well, at that time, could you just give me a round figure estimate? A. I think the whole estate probably ran around two million, seven. I wish I did have the figures at hand, because I might be misstating myself.

Q. Well, you can guess, you don't need to be accurate. Was two million dollars about the figure, more or less? A. About that, I should say.

Q. And you became the recipient of this trust in what year? A. In 1935 I received, let's see, I'm trying to remember my dates, now. I received a fixed amount of income under the trust and at the age of 30 I received half of the estate and the other half was held in trust.

Q. But it was after the establishment of this trust and after you had become the recipient of this trust that you established this laboratory? A. No, it was not. The idea was conceived in the winter of 1935. I was given leave to utilize this old disused stable which had no tenant at 90th and Euclid and it was there, despite the fact that I had very limited resources, (76) I decided to start this laboratory.

Q. Were you working at the bank at this time, also? A. Yes, sir; I was.

Q. When did you work at the laboratory during this year 1935? A. It wasn't until practically into the spring of 1936, I cleaned out the stable and started reconstruction there for our purposes.

Q. Were you working at that time? A. No, sir; I was not. I've forgotten the exact day, but it was around the first day of January, 1936, I terminated my employment with the Central National Bank.

Q. At that time were you a recipient under the trust? A. No, sir; I don't believe I was. I'm trying to remember the exact date there. Really, it wasn't until 1939 that I became a recipient to any large extent under this trust income.

Q. Were you getting income from this trust in 1936? A. Oh, yes.

Q. Do you remember the approximate amount of the income? A. No, I can't. It's a long time ago.

Q. Would it be in five figures, six figures, $5,000, $9,000? A. It was in the neighborhood of that, I can't recall, $8,000 to $10,000, something like that.

* * * * *

(81) Q. I see, and my records show another fee of $8 for velocity test of cartridges. You were always doing that? A. Yes, we are.

Q. And the last item is for $625 for the fees for writing articles for the National Rifle Association. Do you recall that? A. Yes, sir; I do. I don't recall exactly what articles they covered, but we were doing work for them, that was in 1948.

Q. 1948? A. 1948. We had already installed this universal mount and pressure gun setup that we have today. We are the only independent laboratory in the United States that has such equipment, and that is one of the many reasons that the National Rifle Association came to us to prepare this information (82) for publication for their very large membership.

Q. I see. Now, that's all the items I have, and I believe that adds up to the $730.10 that is reported on the return. Can you think of any other income you had in 1948 in that business? A. If it's not there, I can't think of it; no, sir.

Q. Now, what did you and what did Mr. Munhall do at this laboratory during the year? I have only one, two, three, four occasions on which services were rendered for rather minimal amounts. I wondered just what you did do during the year. A. As I stated before in my testimony,

we were busy analyzing, codifying, cataloging, trying to get all this tremendous load of work that had accumulated during the war. As I said before, Mr. Munhall, and I believe there was just one girl we had then, more or less kept the candle burning in the window just while I was gone during the war, and there was a tremendous amount of material that came out of the war that we should know about, I mean that we were expected to know about. I dislike the word expert in connection with my activities, because I have seen a great many people who called themselves experts and I wonder about myself when anything tough comes up; but anyway, we had this tremendous load of work measuring, taking cartridges apart, analyzing the powder, weighing the powders, classifying these cards (83) so that with simple ammunition, a person could bring in a cartridge and from our records could practically pick the thing right out. It was a tremendous undertaking.

We have in the neighborhood at the present time, of course it is always growing, not so much now that the war is over, 13 or 14 thousand rounds of different rifle, pistol, and shot gun ammunition, all of different types, different characteristics, and things that have never been pulled together before, so that, well, the thing to say it's like a very large comprehensive library that you go to and get what you want.

Q. Was that the principal activity of you and Mr. Munhall during the year 1948, research cataloging? A. Yes, sir; I would say that it was primarily that.

Q. How much did you pay Mr. Munhall? Was he an employee of your company? A. Yes, sir. I don't recall the amount I paid him. I believe in your papers there you probably have the bulk amount of the salaries, but I don't have—

Q. Yes, the tax return for 1948, Exhibit 5, indicates a payroll of $15,462.53. To whom was that money distributed? A. That was distributed to Mr. Munhall who had just become my associate, who was at one time at Aberdeen Proving Ground during the war. He became my associate after the war and became one of my mechanics.

I believe Mr. Wieman (84) was working for us at that time. Then we had an additional girl that acted as a general typist and secretary to Mr. Munhall. Of course, we had our porter that we had. I believe there was a change after the war, but the same job was held. I believe that was the group, outside of my own secretary. She was replaced after the war, but it was the same job.

Q. And most of those people to whom this $15,000 odd was paid were helping you and Mr. Munhall working on the principal job you had in 1948 of research and cataloging? A. No, they weren't. My secretary was almost entirely devoted to the managing of my personal affairs. As you can imagine, as you stated there, it was rather a large amount and it requires considerable bookkeeping, as you can tell from that return there. Her time was devoted almost entirely to me. Some of Mr. Munhall's time was devoted to the conduct of my affairs.

Q. When you say your affairs, you mean— A. The estate.

Q. The estate? A. Yes, sir.

Q. How much of your time was spent on the preservation and conservation of your estate at that time? A. I would say offhand that almost half my time was devoted to it.

Q. I see. But the work that Mr. Munhall and the secretary (85) did, with respect to the— A. Yes, sir; as I have stated.

Q. —was with respect principally to the work of identification with the cataloging and research? A. That was almost entirely it with the exception, of course, of building new equipment and resources and setting up new techniques. You can call that research or you can call it building, I don't know which term you like, but it was confined within the company.

Q. After you had gotten this information on cartridges, you have published, haven't you, volumes? A. Yes, we have. Actually, one book wasn't published until 1950 or copyrighted until 1950, but that one, I believe, you

have there, I believe, I am familiar with it, is one of our publications.

The Clerk: Offered for identification Exhibit "A."

(Thereupon, the document above referred to was marked Respondent's Exhibit A.)

Q. I hand you, Mr. White, what has been marked for identification Respondent's Exhibit "A," and I ask you if you can identify this as one of the volumes that you were preparing for cartridge identification? A. Yes, sir.

Q. How many volumes have you completed up to date? A. Just two, sir.

(86) Q. Just two? A. Yes.

Q. I see. This volume indicates that it was copyrighted in 1948. Apparently the work was done on this prior to 1948, or was it done during 1948? A. Frankly, my memory is a little poor about that, because as I recall, the publisher had the manuscript. Whether he copyrighted it at the time—as I recall, the book was not actually published until the latter part of 1948 and it was due at the beginning of 1948. Of course, we probably did some proof reading in the latter part of 1948.

Mr. Kennedy: We offer this in evidence.

Mr. Clyne: No objection, your Honor.

The Court: It will be received and marked in evidence.

The Clerk: Exhibit "A" admitted.

(Thereupon, the document above referred to was received in evidence and marked Respondent's Exhibit A.)

The Clerk: Offer for identification Exhibit "B."

(Thereupon, the document above referred to was marked Respondent's Exhibit B.)

Q. I hand you what has been marked for identification as Exhibit B, and I ask you if you can identify it as Volume 2 of the work on cartridge identification? A. Yes, this is Volume 2.

(87) Q. And this volume was copyrighted in 1950, was it? A. Evidently it was, yes, but my memory is very vague on these copyrights, because sometimes they take them out in the name of the author, and sometimes in the name of the publisher.

Q. In these instances, it was taken out in the name of the author? A. I am not sure about that. We have some records that show the first volume was taken out in our name. Whether that one was or not, I don't know.

Q. The exhibit will show. A. Yes.

Mr. Kennedy: I offer in evidence Exhibit "B."

Mr. Clyne: No objection.

The Court: It will be received and marked in evidence.

(Thereupon, the document above referred to was received in evidence and marked Respondent's Exhibit B.)

Q. Those books, Exhibits A and B, are the only two volumes you did in that period? A. In that rough period; yes, sir. We had, of course, the magazine articles, as I say, reprinted there by your knee from the NRA which are a large part reprints of the articles we supplied the National Rifle Association.

(88) The Clerk: Offered for identification Exhibit C.

(Thereupon, the document referred to was marked Respondent's Exhibit C.)

Q. I hand you what has been marked for identification Exhibit C, and ask you if you will tell us what it is? A. I want to be sure that this is the one—the first part of this has to do with loading tools, of which we did not have —yes, beginning about here are reprints of the articles that we contributed a very, very large part to from the information which was contributed by some of the personnel of the National Rifle Association themselves and for the most part, as you will see at the foot of the page here, our company is given credit for the information in

this particular article, and they follow through the book, as I recall.

Q. I see. Can you recall what compensation you received for the articles appearing in this volume? A. I cannot do that, because I don't believe the period covered by that income statement is the period covered by that of the book.

Q. I see. A. And I do recall this, that we did have several conferences and where our fees were constantly increased by the NRA.

Q. Now, in 1949, Mr. White, would you say that the (89) items making up your gross income were about the same as they were in 1948, that is, an occasional fee for ballistics test, some fees for writing articles, and the like? A. As far as I recall; however, I believe, don't you have the statement there, you can read it to me and I can tell you just exactly what the things were, I hope.

Q. Well, the total amount reported on your income tax return was $2,502.26, of which as you can recall, and correct me if I am wrong— A. I'll do my best.

Q. $825 was from the National Rifle Association for fees for writing articles; $500 from Infantry Journal, Inc., various royalties on a book entitled, "Center Fire, Metallic Pistol or Revolver Cartridges." A. That was Volume 1, for your information.

Q. Ohio Edison Company for trial fees, $300. A. That was a damage suit in which we did a good deal of analytic work for them.

Q. About how long did it take you to do that analytic work? A. I have no recollection of it. Mr. Munhall handled the field work on that and I helped on the laboratory work. I was out of town during part of that time.

Q. Would you say it took a month's time? A. Well, no, I wouldn't say that—as far as working (90) time?

Q. Yes, working time. A. No, I wouldn't say it took a month's working time. The whole investigation, I believe, occupied some six weeks or something like that. As I say, I was out of town at the time and I don't recall the exact

circumstances of when he first took the case and made his first investigation.

Q. Did you have a cost system for the laboratory back in these years, 1948 and 1949? A. A very rough one. We have done a much better job since we have moved to Maryland on that particular situation.

Q. As you can recall then and whatever you do recall of that cost system, would you say most of the expenses, including payroll, were attributable to these items that I have read to you as being the source of your income, such as the tests and so on? A. No, sir; I wouldn't say that at all, because harping back to this idea of getting this tremendous mass of information into a workable, pliable, usable shape, required a tremendous amount of effort. Therefore, some of our time and effort went into doing that and naturally that is not reflected or would not be reflected in these fees we charged.

Q. Would you say most of your time and most of the time of your employees had to do with the work that is not reflected in the time you put in? **(91)** A. Yes, I would say the majority of the time was.

Q. Now, Mr. White, there has been some reference in the record to a letter you received from the National Rifle Association, but that letter is not in evidence. I believe you do have in evidence the statement by you that you received an offer from the American Rifle Association to buy your plant down in Maryland, is that correct? A. Yes, sir.

Q. Was that really an offer or was it something that might be considered less than an offer? A. Well, that's pretty hard to say, being in the nebulous stage like that, it's quite obvious that the NRA needs the facilities like we have. Whether or not they would be able to, or foresee that they could pay the price necessary to purchase our plant is something I cannot answer.

Q. They never made the offer in terms of money, did they? A. No, they did not.

Q. Is the American Rifle Association a non-profit organization? A. Yes, sir; it is.

Q. Where is— A. They have 300,000 members.

* * * * *

(93) Q. Have you ever done any work for arms' manufacturers? A. I'm just trying to recall now. We have on occasion, you could call it, done work for them, because, of course, arms embraces the entire field. We have done work for arms' manufacturers.

Q. For whom? A. I believe we did some work for the Remington Arms Company in connection with the finding of some information which was evidently lost from their files for the purposes of their advertising department. Now, I may be wrong about the name of the company, but that was the nature of the work, as I recall.

Q. Well, they usually don't have any reason to call upon your organization? A. No, sir; they have not, generally speaking, however, (94) we are still trying to sell them.

Q. You testified that the Treasury Department paid you on occasion for evaluating certain illegal weapons that had been seized. A. That's right.

Q. Do you recall how much the Treasury Department paid you? A. A nominal amount, I believe, between $2 and $5 per person and they had to have either two or three persons' signatures on that particular declaration.

Q. About how many times did that occur in the years that we have, 1948 and 1949? A. I don't know. It would be on your record there, I think. You could find it.

Q. In any event, you received only a nominal fee? A. Oh, yes.

Q. The catalogue of cartridge identification that you were viewing this morning, I don't believe it was put in evidence, which you testified you were the author of and which you said was used by the FBI, do you recall how much the FBI paid you or the publisher of the book for the volume? A. I believe the price was $50.

Q. I see. About how many of those were sold in the United States? A. I don't have any records available. There weren't (95) a great many of them.

Q. What was your share of the $50 price? A. I believe our production price on that volume, as I recall, likewise was in the neighborhood of $18 to $20. If you will examine the volume, it is not printed in the usual way, but is made from blueprints and it was the only way we could get the thing out and get it done and keep it confidential at the same time.

Q. About how long did it take to compile the material that is in that volume and have it in suitable form for publishing? A. I don't recall.

Q. Could you give us any estimate on it, on the time? A. No, I couldn't, because I was not at the laboratory during all the period of preparation. I don't know how much time was actually spent on it. Naturally, there were lag times on it. The information, as far as the base marks, is in one part of our catalogue and the information about the manufacturers is for the most part in another part and those two had to be correlated and cross checked, and I don't recall how long it took.

Q. I see, because you weren't around when it was being done? A. I wasn't there during all the preparation.

Q. How about Exhibits A and B, they are the volumes 1 and (96) 2 of the cartridge identification series, about how long did it take to compile the information in those volumes and if you recall, what years was it compiled in? A. Well, the actual pulling together, I would rather imagine, of the volume 1 would be off and on during the year 1947 and the early part of 1948. The same would be true of 1949 and part of 1950 for the volume 2.

Q. I see. A. Unfortunately, I don't have any exact records to that effect.

Q. Do you recall how many volumes or how many issues of those two volumes have been sold in the United States? A. I don't have any record on that.

Q. Are you still receiving royalties from them? A. Yes.

Q. In other words, they are being sold today? A. Oh, yes, they are being sold, but they are not a fast-selling item.

Mr. Kennedy: No, I understand. I have no further questions.

RE-DIRECT EXAMINATION by Mr. Clyne.

Q. Directing your attention to the work that you did for the Ohio Edison, which was referred to as being income in 1949, which you stated that you had received $300, how **(97)** much actual time on an hourly basis was spent in the determination of the opinion that you gave Ohio Edison? A. I do not know, sir.

Q. Was that done by someone other than yourself? A. Yes, sir.

Q. The work that was done in the preparation of articles for any and all magazines and all books that were published, was the information that was contained in those articles and books, by that statement, from your library of books, cartridges, shells, and engineering data that you had accumulated over a period of years up until now? A. Yes, sir.

Q. Was the cataloging of that information and the engineering detail that you accumulated in connection with guns and ammunition from the time your laboratory was established until now, is it now a usable tool by which your ability to produce and sell your opinions is predicated? A. Yes, it is, so far as I understand your question, it is a very usable tool and it was not usable before sir.

* * * * *

(98) Q. In the inquiries that you have made or in the conduct of your business, is it the fact, state the fact as to whether or not either you or any part of your organization act as a sales organization and go out and solicit business? A. Yes, sir.

Q. Who does that soliciting, if anyone? A. I do soliciting. Mr. Munhall does soliciting, and one of the other associates does some soliciting from time to time. Mr. Munhall and I are the mainstay of our selling force.

Q. What does Mr. Munhall do, Mr. White? A. Mr. Munhall has the title of manager of the H. P. White Laboratories.

Q. What does he do in connection with the sales activities, who does he call on, if he does? A. He calls on the arms plants, both the technical men and the sales—the people that generate the sales policy, in order to see whether or not our services may be available and to cement relationships between ourselves and the larger companies, to keep abreast of what is going on in our field and, of course, to see if we cannot be of assistance to their sales departments where they do not have or care to enter into a program to make their particular advertising more pleasing to the customer and make the production better.

(99) Q. Who do you call on, the same or other people, other users than that? A. Generally speaking, I call on the same people myself. Quite frequently, we do it together.

Q. Who, if anyone, calls on Governmental Agencies? A. We both do, sir.

Q. Who procured the contract that you are now working on? A. Well, I can say that we both did, because we were both on the same trip in which we were—the wheels were set in motion for our present existing contract.

Q. Tell me in connection with your present contract that you have with the Government, does that involve both guns and ammunition? A. Yes, sir.

Q. How many rounds of Government-owned ammunition do you now have in storage for use in connection with your contract with the Government, how many pieces do you have? A. We have in the neighborhood of between 40 and 50,000 rounds of automatic cannon ammunition.

Q. Automatic cannon ammunition? A. Yes, sir.

Q. What size shell is that? A. Twenty millimeter.

Q. Would you have been able to have handled 20 millimeter (100) shells in your laboratory in Cleveland? A. No, sir.

Q. Your present range makes that particular type of testing possible? A. Yes, sir.

Q. How high a caliber of shell can you now handle in your present laboratory in Bel Air? A. We can handle between 20 and 30 millimeter.

Q. And what was the highest grade ammunition or highest size ammunition that you could handle with your laboratory when your laboratory was in Cleveland? A. We could only safely handle 45 caliber rifle ammunition.

Q. Have the number of customers that you have now served in the year of 1953 up until now increased over, let's say, last year or the year before? A. No, sir; they have not increased.

Q. Has the volume of business you have done with each customer increased? A. Yes, sir; it has.

Q. And you say that you will on the basis of the present curve of your production operate at a profit next year? A. Yes, sir.

Q. Would you say from your best judgment of the work (101) that you now have on the books for the year of 1953 whether or not you will operate at a profit in the laboratory? A. I am not concerned enough with my immediate operating figures to be able to tell you that, sir. I believe that we are going to be coming fairly close.

Q. By the way, who is the head of the organization known as the National Rifle Association? A. Oh, my, I don't know the name of the president of the National Rifle Association. He is a civilian who is, of course, the head of the Board of Directors. The executive secretary who, of course, is usually the most active managerial position, is the executive secretary, and that is ex-Major General Edson of the Marine Corps.

Q. And is he the man with whom you have had your conversations? A. I have had some conversations with General Edson, but most of my conversations have been with Major General Hatcher, retired, who was a Major General in the Ordnance Department and who served in both wars with considerable distinction in our general field of design and manufacture in the Ordnance Department.

Q. Have your conversations with him related to your use of your laboratory as part of their membership offering, was that what was part of his plan? A. That was a conversation I have discussed with (102) various people on the technical staff and General Edson, who you must

realize is in the chief managerial position, the possibility of the use of our facilities for furthering their programs.

Q. Have you had similar suggestions from any magazine authorities that serve the sporting field? A. Yes, sir; we are in the process of negotiation with another—I would not say another, with a sporting magazine. Of course, it supports itself by its advertisers and by the people that purchase the magazine. It is not an association. It is a public publication.

Q. And they are also attempting to contract with you for engineering? A. For our services.

Mr. Clyne: Thank you, that is all.

Mr. Kennedy: Just a few more questions, Mr. White.

The Witness: Surely.

RE-CROSS EXAMINATION by Mr. Kennedy.

Q. That contract you have with the Government, is that with the Navy Department? A. Yes.

Q. What price did you quote the Navy Department for the full job? A. I don't recall.

(103) Q. You did give them a figure? A. Yes, we did.

Q. Well, could you give me some idea of what that figure was? A. Well, I would say that it goes into about five figures.

Q. And would you say around $12,000, $13,000, something like that? A. I think it is in excess of that.

Q. $20,000? A. Well, you see, it's one of those things that you quote, your first quote is a definite quote, a bid, and then, of course, they expand your contract and it's cost plus from there on.

Q. How does the situation stand today, what is your bid today? A. I don't know the final figure on it so far, because they keep on amplifying it and I hope they keep on doing it, incidentally.

Q. Would you say $25,000? A. Somewhere in there.

Q. And your profit would be 6 per cent on that? A. Seven per cent.

Q. Seven per cent? A. Yes, sir.

* * * * *

The Court: * * * (107) In the meantime, I have some questions.

Mr. White, perhaps you better look at Exhibits 3 and 4, your income tax returns for those years, and 4 and 5. Now, the years that are involved here are 1948 and 1949.

The Witness: Yes, sir.

The Court: And you have now before you Exhibits 4 and 5 which are your income tax returns for those years.

The Witness: Yes, sir, I signed them.

The Court: I wish you would turn to the schedule which shows the detail of the items of operating expense in those years for the business that you operated under the name of the White Ordnance Company.

The Witness: Yes, sir. Do you want me to turn to both of them, sir, or just one?

The Court: One may be enough, or you can turn to them both. Now, can you tell me, the biggest figure there is for salaries, is that correct?

The Witness: Yes, sir; it is.

The Court: Can you tell me what portion of the salary, the total salary paid to your secretary and Mr. Munhall is included in that figure?

The Witness: There is none of my secretary's salary included in this laboratory payroll figure. Half of Mr. Munhall's salary is reflected in this figure here. The rest of the people in the laboratory are included in that (108) particular payroll figure.

The Court: Well, perhaps I misunderstood you, but I thought I understood you to say that at the laboratory you employed certain people?

The Witness: Yes, sir.

The Court: And you included someone, I thought, that you designated as your secretary.

The Witness: Yes, sir; I did.

The Court: But even though you employ and you say you employ her in the laboratory, no part of her salary is included in that figure?

The Witness: No, sir.

The Court: Is that correct?

The Witness: That's correct, sir.

The Court: How did you arrive at the figure of one half for Mr. Munhall?

The Witness: That was pretty much arbitrary, sir, from what little survey we could make of the situation. Such a thing, as I say, we did not have exact time clock schedules or anything like that, but from our appraisal of the situation, that seems to be the proper proportion to apportion to his period of time on my personal affairs or on the laboratory, whichever way you want to look at it.

The Court: Outside of those two employees, were there any that worked on anything except work for the laboratory?

The Witness: No, sir; there were none.

(109) The Court: All of the salary, except Mr. Munhall's was for employees working exclusively on the laboratory?

The Witness: Yes, sir; anything they did for anybody else was always billed out and came back to the laboratory.

The Court: Well, if it came back to the laboratory, it would be reflected in your gross income, wouldn't it?

The Witness: Yes, sir, that's right.

The Court: Was any of that reflected in any of the figures Mr. Kennedy read to you for 1948 and 1949?

The Witness: Gee, I'm sorry, sir. I'm afraid I got lost on that. I am not trying to obstruct anything here, but—

The Court: I understood you to say if any of the other employees did work for anybody else or spent their time doing work for anybody other than the laboratory, I assume that includes your own personal affairs?

The Witness: May I give you an instance, sir? As you probably know, where expert testimony is required, for say a civil case or even in a criminal case, the expert testifier must do the investigation, the investigative work himself in order to be able to swear to it. Consequently when he receives a check, it is made out to him personally. Those checks were endorsed back to the company, is what I was trying to get across.

The Court: In other words, some of the sums that you (110) have referred to as being received in 1948 and 1949 may have been received by you in that fashion, is that correct?

The Witness: Generally speaking, they were not received by me, but by Mr. Munhall, who, as I stated previously, has done a good deal of the legal work and the legal testifying for the firm.

The Court: But I mean, if I understand what you said just a minute ago, that if Mr. Munhall received that money in the first instance, he turned it over to you?

The Witness: No, he turned it over to the firm.

The Court: Well, there isn't any firm, is there?

The Witness: No, but we try to keep the books separate.

The Court: That may be, but you are the White Ordnance Company, aren't you?

The Witness: Yes, sir.

The Court: So if Mr. Munhall received any fees in the way you have described, he turned them over to you?

The Witness: Yes, sir.

The Court: Well, some of that may be represented in the figures that Mr. Kennedy read you for receipts during 1948 and 1949?

The Witness: Yes, sir; it would be all represented there.

The Court: I mean, some was paid to you in that (111) fashion?

The Witness: Yes, sir.

The Court: Now, will you look at that schedule again there and I would like to ask you about the matter of advertising.

The Witness: Yes, sir.

The Court: Do you have any examples of the advertising that you did during 1948 and 1949 for which that money was spent?

The Witness: This is an all-inclusive term. We do do display advertising, sir. It represents the money expended

by going to see the different manufacturers and people that might be interested in our services.

The Court: You mean, in other words, like traveling expenses?

The Witness: Yes, sir; like traveling expenses. Naturally, occasionally we come to a town and we will have to entertain to a small extent, nothing elaborate or anything like that, but you can buy a lunch for somebody.

The Court: But this does include that item also?

The Witness: Yes.

The Court: You might take somebody to lunch?

The Witness: Yes.

The Court: Does it include some traveling expense?

The Witness: Yes, sir.

(112) The Court: That you might undertake?

The Witness: Yes, sir.

The Court: There is no breakdown of that figure in the schedule.

The Witness: There is no breakdown.

The Court: I wish you would look at the other also and tell me if there is any breakdown in that.

The Witness: No, sir; there is not.

The Court: Now, another of the items there is for depreciation.

The Witness: Yes, sir.

The Court: Depreciation, on what was that?

The Witness: On all the capital property, I assume, sir. As I say, I am not too good at these figures, but I assume that was what it was for.

The Court: Now, in those years, where was your plant located?

The Witness: At 90th Street and Euclid.

The Court: In Cleveland?

The Witness: Yes, sir; in Cleveland.

The Court: Did that figure also include, I mean to say, what you call capital items on which you took depreciation, that also includes your equipment, your machines?

The Witness: Yes, sir; anything that is capital.

The Court: Now, for this year, that is, 1953, you (113) have testified that you expect to approach breaking even, as I understand it, is that right?

The Witness: Yes.

The Court: During this year, where is your plant located?

The Witness: In Bel Air, Maryland, or in the vicinity of Bel Air, Maryland.

The Court: Is that the plant that was shown on, I think it is Exhibit 1, the photographs?

The Witness: Yes, sir.

The Court: Did you include in your estimate expectation that you will almost break even and items for depreciation on that property?

The Witness: No, sir; I don't have those figures.

The Court: No, but I mean, when you said to Mr. Clyne that you expected to come near to breaking even this year and being in the black next year, did you include an item for depreciation on that plant and its contents?

The Witness: I believe so. Frankly, I'm sorry to say, it's embarrassing to be so dumb about these figures on my business, but I do assume they include depreciation figures. I asked the people how they were doing on the operation and they tell me that we are coming along in pretty good shape.

The Court: Do you have an estimate how much capital (114) investment is involved in that plant that is shown on that exhibit?

The Witness: Yes, sir; I should say in the neighborhood of $300,000.

The Court: Do you include in your estimating—by the way, that is Exhibit A I was just referring to.

Do you include in computing your probable profit or loss for 1953 and 1954 any amount for interest in the investment of that plant?

The Witness: No, sir; I don't believe we do.

The Court: And do you include in your total figures, either for 1948 or 1949, for your estimates, any amount whatever for the value of your own services?

The Witness: No, sir; that was not reflected in these statements.

The Court: I have no further questions.

Mr. Clyne: May I have the Court's permission to ask one?

The Court: Yes.

FURTHER RE-DIRECT EXAMINATION by Mr. Clyne.

Q. From the time you were in high school up until now, what sort of hobby have you enjoyed throughout the years? A. Well, I'm primarily a sailboat hobbyist.

Q. That has been your pleasure from college up until (115) now? A. Yes, sir.

Mr. Clyne: Thank you. That's all.

Mr. Kennedy: No further questions.

Mr. Clyne: No further questions.

The Court: All right, Mr. White.

(Witness excused.)

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FINDINGS OF FACT AND OPINION OF THE TAX COURT (23 T. C. No. 12).

(Filed October 19, 1954.)

A ballistics laboratory, owned by petitioner, and operated consistently at a loss *held*, on facts, not a business carried on for profit and the excess of expenditures over income not deductible as either a loss or business expense under section 23, Internal Revenue Code of 1939.

Respondent determined deficiencies in income taxes of petitioners for the calendar years 1948 and 1949 in the amounts of $1,088.51 and $10,014.28, respectively. Petitioners, in addition to resisting the deficiency determinations, claim that, if they prevail, there has been an overpayment of income taxes for the calendar year 1948 due to certain conceded arithmetical errors.

The question presented is whether petitioners were entitled to deduct under section 23 expenditures claimed to be ordinary and necessary expenses of a trade or business.

FINDINGS OF FACT.

[1]* Petitioners, Henry P. White and Nancy A. White, husband and wife, filed joint income tax returns for the calendar years 1948 and 1949 with the collector of internal revenue for the eighteenth district of Ohio.

[2] On March 19, 1951, petitioners filed with respondent a claim for a refund of $7,671.05 for the year ending December 31, 1948.

[3] Petitioner Henry P. White, hereinafter sometimes called petitioner, was graduated from Cornell University in 1934 with a degree in engineering and was licensed as a mechanical engineer by the states of Ohio and Maryland. He sold automobiles for the remainder of 1934 and was employed by the Central National Bank of Cleveland in 1935.

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* Bracketed numbers supplied by counsel.

He also became the sole beneficiary in 1935 under a trust of approximately $2,000,000.

[4] In 1936, petitioner opened a ballistics laboratory in Cleveland, Ohio, specializing in guns and ammunition research, and in such work employed the services of subordinates. Until petitioner went into the armed service this laboratory had continued to function under his direct supervision. During petitioner's absence, his first assistant operated the laboratory. When petitioner returned from the service, he again took over direction and management of the laboratory and it has continued to function under his supervision through the years in question. This research laboratory is now located at Bel Air, Maryland, in proximity to Army and Navy Proving Grounds.

[5] Operation of the laboratory included the preparation and publication in 1948 of a book entitled "Centerfire Metric Pistol and Revolver Cartridges," and research preparatory to the publication in 1950 of a second book entitled "Centerfire American and British Pistol and Revolver Cartridges," but income realized from sales of the first book during the years in controversy did not exceed $500. No attempt was made in the years in issue to segregate those expenditures properly attributable to producing the copyrighted publications and laboratory research library data, although it appears that most of the endeavors of petitioner and his associates were connected with the named activities.

[6] During the years involved, approximately one-half of petitioner's time was devoted to the preservation and conservation of his estate. His secretary expended all of her time upon petitioner's personal affairs. The general manager of the laboratory spent half of his time on the personal affairs of petitioner. An arbitrary method of allocating the latter's salary according to the time spent on petitioner's personal affairs and the laboratory endeavors was used.

[7] Petitioners' joint income tax returns for 1948 and 1949 reported the following income and expense items in

the operation of the ballistics laboratory resulting in net losses which were disallowed by respondent:

[8]	1948		
Income			$ 730.10
Expenses:			
Payroll		$15,462.53	
Office Supplies		1,900.49	
Shop & Laboratory Supplies		1,376.96	
Advertising		1,976.61	
Social Security		133.38	
Unemployment Compensation		66.70	
Workmen's Compensation		73.01	
Personal Property Tax		618.64	
Insurance (⅓)		181.62	
Telephone		458.94	
Burglar Alarm		447.30	
Utilities		680.79	
Cleaning		81.82	
Repairs		137.07	
Post Office Box		6.00	
Auto Expense		288.72	
Police Commissions		42.00	
Miscellaneous		242.51	
Legal		35.00	
Surety Bonds		53.00	
Depreciation		2,039.71	
		$26,302.80	
Less: Administration of investments		6,947.88	19,354.92
	NET LOSS		$18,624.82

[9] 1949

Income		$ 2,502.26
Expenses:		
Payroll	$19,104.61	
Shop and Laboratory Supplies	851.51	
Office Supplies	1,846.03	
Advertising	1,668.50	
Payroll Taxes	254.42	
Workmen's Compensation	95.55	
Fire Insurance (⅓)	202.65	
Other Insurance	124.50	
Burglar Alarm	453.60	
Telephone	477.51	
Light, Power and Water	774.09	
Cleaning	107.01	
Post Office Box Rent	6.00	
Auto Expense	297.32	
Repairs	256.67	
Miscellaneous	208.23	
Police Commissions	43.40	
Depreciation	2,342.06	
	$29,113.66	
Less: Administration of investments	8,090.38	21,023.28
NET LOSS		$18,521.02

[10] Of the $730.10 income received from the operation of the ballistics laboratory in the year 1948, $625 was acquired in fees for writing articles for the National Rifle Association.

[11] The ballistics laboratory was of some service and benefit to a limited number of persons and organizations, but it was not capable of producing income in sufficient amount to offset the usual expenses. Petitioner has never made a profit from the operation of the ballistics laboratory; it has incurred losses in every one of the 17

years from its inception in 1936 to the time of trial in 1953. For example, petitioners' joint income tax return for the calendar year 1951 revealed that they suffered a $33,369 loss.

[12] Subsequent to the taxable years in question petitioner made a capital investment of $300,000 for the construction of a new ballistics laboratory in Maryland. In determining whether his new enterprise would be profitable petitioner has figured no amount for interest on this capital investment, nor has he figured any amount for the value of his own services for the years 1953 and 1954. Petitioner had no real expectation of any net income for years subsequent to those in issue.

[13] Petitioner did not operate the ballistics laboratory as a business or with the intent of making a profit during the taxable years 1948 and 1949.

[14] The expenditures claimed were neither ordinary and necessary expenses of carrying on a trade or business nor losses within the meaning of section 23, Internal Revenue Code of 1939.

OPINION.

OPPER, *Judge*: Whether the amounts presently in controversy are claimed as "losses" or as ordinary and necessary business expenses, the existence of a profit motive on the part of petitioner is requisite.[1] The principle which we are now required to apply has been aptly stated by Judge Learned Hand sitting as a District Judge in *Thacher v. Lowe* (S. D., N. Y.), 288 F. 994, 995:

> * * * It does seem to me that if a man does not expect to make any gain or profit * * * it cannot be

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[1] "* * * An occupation or employment will not be excluded from the classification of business merely because it actually results in loss instead of profit; but it is essential that livelihood or profit be at least one of the purposes for which the employment is pursued, * * *" *Deering v. Blair* (C. A., D. C.), 23 F. 2d 975, 976. See also *Chaloner v. Helvering* (C. A., D. C.), 69 F. 2d 571, 572.

> said to be a business for profit, and while I should be the last to say that the making of a profit was not in itself a pleasure, I hope I should also be one of those to agree there were other pleasures than making a profit. * * * it does make a difference whether the occupation which gives him pleasure can honestly be said to be carried on for profit. Unless you can find that element it is not within the statute, * * *.

Nor do we think it necessary that "pleasure" be equated with idleness or that financial return is the indispensable equivalent of public benefit. The gratification derived from an occupation worth doing, possibly beneficial to others and probably requiring long hours of arduous labor, must still not be confused with an intention to return a profit. We find no evidence here that petitioner did, or could in good faith, have had such an intention during the years in dispute.

Petitioner's independent wealth, the long history of losses,[2] and the entire disproportion of receipts to expenditures[3] may not singly and individually be conclusive. But when considered together and coupled with the necessity of overcoming the burden of proof imposed upon petitioner, they lead us to the conclusion that as of the tax years before us, anyone of his intelligence, education and ability, with knowledge of the facts, could not in good faith reasonably have expected or intended to operate his ballistics laboratory profitably.

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[2] "* * * It would be specious to say that a vain hope that on some remote day a profit may result is enough to give the operation * * * the character of trade or business. It is far different from saying, as the Board and the courts have in other cases, that the fact of a loss does not deprive a business enterprise of its character as a business. * * *" *Louise Cheney*, 22 B. T. A. 672, 674.

[3] "* * * But if the gross receipts from an enterprise are practically negligible in comparison with expenditures over a long period of time it may be a compelling inference that the taxpayer's real motives were those of personal pleasure as distinct from a business venture, * * *" *Cecil v. Commissioner* (C. A. 4), 100 F. 2d 896, 899.

Such statements as the following from petitioners' brief are thus wide of the mark: "We * * * know the value of research and the many benefits that result from it." It may readily be granted that petitioner's work has been useful and perhaps unique; that he has rendered service not only to industrial producers but to local and even Federal government.

But when over a period of some 12 years the expenses of operation always exceeded the financial return, when in the period here involved the proportion of cost to income averages in the neighborhood of 12 to 1, when we know from the record that even in a subsequent year there was not only no profit but even an increased loss, it strains the credulity to conclude that the purpose of these activities was to earn money as contrasted with performing a public service.

Paraphrasing *Louise Cheney*, 22 B. T. A. 672, 674, petitioner's intention was not to run a business or make a profit but to obtain the personal gratification of fulfilling a recognized need. Petitioner is to be commended for the devotion of his time and effort in a worth-while endeavor. But this does not supply the missing element of profit motive.

This disposition renders unnecessary any consideration of respondent's alternative contention that the expenses must, in any event, be disallowed because to some undisclosed extent they resulted in the acquisition of capital assets.

Decision will be entered for the respondent.

DECISION OF THE TAX COURT.

(Entered Oct. 19, 1954.)

Pursuant to the determination of the Court, as set forth in its Findings of Fact and Opinion, filed October 19, 1954, it is

ORDERED AND DECIDED: That there are deficiencies in income tax of $1,088.51 and $10,014.28 for the calendar years 1948 and 1949, respectively.

Enter:

CLARENCE V. OPPER,
Judge.

APPENDIX B.

Internal Revenue Code, 1939, Sec. 23.

DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(Sec. 23(a))

(a) Expenses—

(1) Trade or business expenses—

(A) In General—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and rentals or other payments required to be made as a condition to the continued use or possession, for the purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

STATEMENT OF QUESTION INVOLVED

Was the ballistics laboratory owned by the taxpayer, Henry P. White, operated during the taxable years with the intention of making a profit so as to enable the taxpayers to deduct expenditures in excess of income incurred in its operation as ordinary and necessary expenses of a trade or business or as losses incurred in a transaction entered into for profit under Section 23 of the Internal Revenue Code of 1939?

The Tax Court answered "no."

The Commissioner contends that the answer should be "no."

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In the United States Court of Appeals
for the Sixth Circuit

No. 12, 445

HENRY P. WHITE, AND ESTATE OF NANCY A. WHITE, DECEASED, T. LEO SULLIVAN, ADMINISTRATOR, C. T. A., PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

ON PETITION FOR REVIEW OF THE DECISION OF THE TAX COURT OF THE UNITED STATES

BRIEF FOR THE RESPONDENT AND APPENDICES

COUNTERSTATEMENT OF FACTS

The taxpayers in their statement of facts (Br. 1-9) have ignored the findings of fact made by the Tax Court and have instead attempted to summarize the testimony presented to the Tax Court. For this reason, the Commissioner deems it necessary to submit a counterstatement of the facts.

The Tax Court made findings of fact (R. 65a-69a) [1] which may be summarized as follows:

In 1934, Henry P. White was graduated from Cornell University with a degree in engineering and was li-

[1] Record references are to the Appendix of taxpayers' brief.

censed as a mechanical engineer by the States of Ohio and Maryland. He sold automobiles for the remainder of 1934 and was employed by a bank in Cleveland in 1935. In 1935 he became the beneficiary under a trust of approximately two million dollars. (R. 65a-66a.)

In 1936, he opened a ballistics laboratory in Cleveland, Ohio, specializing in guns and ammunition research. He employed others to assist him in such work. The laboratory was operated under White's direct supervision until he went into the armed forces; while he was absent from the laboratory and in the armed forces, the laboratory was operated under the supervision of his first assistant. On his return from the service, White again assumed the direction and management of the laboratory and it has continued under his supervision through the years in question. The laboratory is now located at Bel Air, Maryland, in proximity to Army and Navy Proving Grounds. (R. 66a.)

Operation of the laboratory included research and preparation for the publication of two books concerning pistol and revolver cartridges. One of these books was published in 1948 and the other in 1950; income from the sales of the first book did not exceed $500 during the taxable years. No attempt was made during the taxable years to segregate expenditures properly attributable to producing the copyrighted publications and laboratory research library data, although most of the endeavors of White and his associates were connected with such activities. (R. 66a.)

White devoted about one-half of his time to the preservation and conservation of his estate during 1948 and 1949. The general manager of the laboratory also spent one-half of his time on White's personal affairs. White

used an arbitrary method of allocating the general manager's salary according to the time which was spent on the laboratory affairs and White's personal affairs. (R. 66a.)

The joint income tax returns filed by White and his wife reported income and expenses relating to the operation of the laboratory as follows (66a-68):

	1948	1949
Income	$ 730.10	$ 2,502.26
Expenses (less administration of investments	$19,354.92	$21,023.28
Net Loss	$18,624.82	$18,521.02

Of the $730.10 income received from the operation of the laboratory in 1948, $625 was acquired in fees for writing articles for the National Rifle Association. (R. 68a.)

The laboratory served and benefited a limited number of persons and organizations, but was not capable of producing income in amounts sufficient to offset the usual expenses. White has never made a profit from the operation of the laboratory; rather its operations have resulted in losses in each of the 17 years from its inception in 1936 to the time of the trial in 1953. The joint income tax return filed by White and his wife for the year 1951 disclosed a loss of $33,369 from the laboratory operations. (R. 68a-69a.)

Subsequent to the taxable years White made an investment of $300,000 for the construction of a new laboratory in Maryland. In determining whether his new enterprise would be profitable, he did not take into account any amount for interest on that investment or for

the value of his own services. He had no real expectation of any net income for years subsequent to the taxable years. (R. 69a.)

White did not operate the laboratory as a business or with the intention of making a profit during the years 1948 and 1949. The claimed expenditures were neither ordinary and necessary expenses of carrying on a trade or business nor losses within the meaning of Section 23 of the Internal Revenue Code of 1939. (R. 69a.)

These findings of fact were filed together with the Tax Court's opinion on October 19, 1954. (R. 65a.) The Tax Court's decision was entered on the same day. (R. 72a.)

ARGUMENT

Was the Ballistics Laboratory Owned by the Taxpayer, Henry P. White, Operated During the Taxable Years With the Intention of Making a Profit So as to Enable the Taxpayers to Deduct Expenditures in Excess of Income Incurred in Its Operation as Ordinary and Necessary Expenses of a Trade Or Business Or as Losses Incurred in a Transaction Entered Into For Profit Under Section 23 of the Internal Revenue Code of 1939? The Tax Court Answered "No". The Commissioner Contends That the Answer Should Be "No".

The taxpayers are claiming deductions from gross income for amounts purportedly representing expenditures incurred in the operation of the ballistics laboratory owned by Henry P. White, during the taxable years, 1948 and 1949. There is no dispute that the amounts claimed were actually spent by the taxpayers. The only question is whether these amounts represented expenses incurred by the taxpayers in the operation of a trade or business or whether they can be considered to represent losses incurred in a transaction entered into by the taxpayers for profit within the meaning of Sec-

tion 23 of the Internal Revenue Code of 1939 (Appendix A, *infra*).

It is clear that the criterion for determining whether or not an expenditure was incurred in the operation of a trade or business is that the enterprise must have been entered into with the intention of profiting from its operation. *Helvering* v. *Nat. Grocery Co.*, 304 U.S. 282, 289, fn. 5; *Thacher* v. *Lowe*, 288 Fed. 994 (S.D.N.Y.); Cf. *Ewing* v. *Commissioner*, 213 F.2d 438 (C.A. 2d). It is also clear that an incidental expectation or hope of profit from the enterprise is not sufficient to cause the undertaking to be considered a "trade or business" within the meaning of the statute. *Cheney* v. *Commissioner*, 22 B.T.A. 672. Rather, the intention to profit must be the primary and dominant purpose of the taxpayers' endeavor. *Coffey* v. *Commissioner*, 141 F.2d 204 (C.A. 5th), and *Ewing* v. *Commissioner*, *supra*. Whether the requisite profit intention is present is a question of fact which is primarily a determination to be made by the lower court to which Congress has given the responsibility of making findings of fact. *Morton* v. *Commissioner*, 174 F.2d 302, 303 (C.A. 2d), certiorari denied, 338 U.S. 828. And such findings are not to be disturbed by an appellate court unless they are found by the appellate court to be clearly erroneous.[2] *United States* v. *Gypsum Co.*, 333 U.S. 364, 395, rehearing denied, 333 U.S. 869; *Morton* v. *Commissioner*, *supra*, and *Wright-Bernet* v. *Commissioner*, 172 F.2d 343 (C.A. 6th). The instant case must be considered with these principles in mind.

The Tax Court found that Henry P. White "did not operate the ballistics laboratory as a business or with

[2] See also Section 7482(a) of the Internal Revenue Code of 1954.

the intent of making a profit during the taxable years 1948 and 1949." (R. 69a.) The taxpayers' contention is that the only evidence supporting that finding by the Tax Court is that Henry P. White is a wealthy man and that the business had never made a profit. (Br. 11.) The Commissioner, however, submits that the evidence is compelling to support the Tax Court's finding and that its decision must therefore be affirmed.

Henry P. White commenced the operation of his ballistics laboratory in 1936, shortly after he had inherited a substantial amount of money. Although he had received a degree in engineering in 1934 and was licensed as a mechanical engineer in two states, he apparently did not utilize this training during the remainder of 1934 and 1935. (R. 42a-45a.) The record is devoid of any evidence that White had any knowledge of or training in the field of ballistics. Previous to receiving his inheritance, White had been working as an automobile salesman and later in a bank. (R. 44a.) His earnings were small and he had been receiving financial assistance from his family. (R. 43a.) From these facts, it may reasonably be inferred, that once his financial problems were eliminated (as a result of his inheritance) and it was no longer necessary for him to concern himself with the tasks of supporting himself and his family he turned his attention to a subject which interested him for reasons entirely apart from economic motivations. His entrance into the field of ballistics and ammunition research can be thus explained.

Moreover, the manner in which the laboratory was operated from its inception to the time of the Tax Court hearing is evidence of the fact that the laboratory was not being operated as a true business or with the inten-

tion of making a profit. This is graphically illustrated by the testimony of E. W. Kronbach, one of the taxpayers' witnesses. Mr. Kronbach testified that for work performed for his company by the laboratory in 1940 or 1941, although time and labor were involved, his company was billed only for the instruments installed. He further testified that his company paid "comparatively little" for the work and that the laboratory "didn't make much money on it."[3] (Appendix B, *infra.*) Furthermore, a large part of the time of certain of the laboratory "employees" was spent handling the personal affairs of Mr. White. Indeed, during the taxable years, White himself used one-half of his time in managing his personal matters. (R. 48a, 59a-60a.) And no records were maintained showing the exact amount of time that was used by White's chief laboratory assistant in attending to White's personal affairs. (R. 60a.) But rather, the arbitrary amount of one-half of the salary paid to this assistant was allocated to laboratory work for the purposes of the claimed deductions. (R. 60a.) Arbitrary allocations of expenses to the personal affairs and claimed "business" affairs of Mr. White indicate that it was not of extreme importance to White whether a profit was in fact being realized from the operation of the laboratory.[4]

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[3] Similarly, only a "nominal amount" was received for work performed by the laboratory for the Treasury Department. (R. 53a.)

[4] It should also be noted that no deductions for depreciation on the property occupied by the laboratory was claimed by the taxpayer for the taxable years. (Exs. 4 and 5). On brief (p. 24) the taxpayers state that the Commissioner should not complain because claimed deductions were kept to a minimum. The taxpayers fail to realize, however, that this merely furnishes another indication that White was unconcerned with whether the laboratory was

Although the financial success of the enterprise is not the only factor to be considered in determining whether a profit motive existed, it is certainly most relevant whether losses were being realized and whether a reasonable man could conduct the undertaking with a real expectation of profit. *Thacher* v. *Lowe, supra; Morton* v. *Commissioner, supra.* The evidence on this point, too, sustains the Tax Court's finding that the laboratory operation was not a "trade or business" within the meaning of Section 23 of the Code. From 1936, when the laboratory was founded, and continuing for each year until 1953, when the hearing before the Tax Court was held, the laboratory's expenses exceeded its income and a loss was realized. (R. 68a-69a.) Moreover, the amounts of the losses rather than decreasing, as the laboratory became older, increased. (Testimony of White, Appendix B, *infra.*) The claimed amounts for deductions for the taxable years, 1948 and 1949, were $19,354.92 and $21,023.28, respectively, as contrasted with gross income in those years in the amounts of $730.10 and $2,502.26, respectively. (R. 67a-68a.) And the loss from the operation of the laboratory in 1951 was $33,369.98. (Testimony of White, Appendix B, *infra.*)

In view of such a long history of increasing losses from 1936 until the taxable years, it would require more than optimism to engage, in good faith, in the operation of such an enterprise during the taxable years with the intention of making a profit.

In disallowing the claimed deductions, the Commis-

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producing a profit or loss. Such lack of interest in the financial success of the laboratory is also shown by White's statement that he was "not concerned enough with my immediate operating figures" to be able to predict whether the laboratory would operate at a profit for the year 1953. (R. 57a.)

sioner has not made a determination that the laboratory operated by White has not served a useful purpose. On the contrary, all of the evidence in the record points to the fact that the undertaking was a meritorious one and satisfied a need existing in the arms and ammunition making industries. But this case cannot turn on the relative merits or demerits of the taxpayers' undertaking. The sole question is whether the Tax Court's finding that the undertaking was not a trade or business or a transaction entered into for profit has support in the evidence. And in this connection it must be remembered that the burden of proof in the Tax Court was on the taxpayers. That they did not satisfy this burden is clear from the record and was so stated by the court below. (R. 70a.)

It is true that Mr. White testified that he intended to make a profit from the operation of his laboratory when he first engaged in the undertaking. (R. 40a, 41a.) And the taxpayers contend that this testimony is uncontradicted and that no question as to credibility is raised. The Commissioner presented no witnesses in the Tax Court, but he did cross-examine the taxpayers' witnesses. And the assertion of the deficiency itself challenges White's self-serving statement that he established the laboratory with the intention of making a profit.[5] In the circumstances, the Tax Court, as the trier of fact, was entitled not to believe and apparently did not believe the statements of Mr. White. Cf. *Helvering* v. *Nat. Grocery Co., supra,* p. 295.

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[5] In this connection it should be noted that White did *not* testify that he operated the laboratory with the intent to make a profit *during the taxable years.*

As shown above, there is ample evidence in the record to support the Tax Court's findings of fact. The burden of proving that the laboratory was operated during the taxable years with the intent to make a profit was on the taxpayers. The evidence introduced by the taxpayers was not sufficient to overcome the presumption of correctness which attached to the Commissioner's determination that the laboratory was not operated with a profit motive and the decision of the Tax Court must, therefore, be affirmed.

Respectfully submitted,

H. BRIAN HOLLAND,
Assistant Attorney General.
ELLIS N. SLACK,
MARVIN W. WEINSTEIN,
Special Assistants to the Attorney General.

APRIL, 1955.

APPENDIX A

Internal Revenue Code of 1939:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) [as amended by Sec. 121, Revenue Act of 1942, c. 619, 56 Stat. 798] *Expenses.*—

(1) *Trade or business expenses.*—

* * * * *

(e) *Losses by Individuals.*—In the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—

(1) if incurred in trade or business; or

(2) if incurred in any transaction entered into for profit, though not connected with the trade or business; or

* * * * *

(26 U.S.C. 1952 ed., Sec. 23.)

APPENDIX B

Testimony of Calvin H. Goddard

[Tr. 20]

CROSS EXAMINATION

By Mr. KENNEDY:

• • • • •

[Tr. 22-23]

Q. Did you have as much investment in your laboratory as Mr. White has in his?

A. No, I should say I have personally about $10,000 and what White had, I don't know. He was the fellow into whose good will I bought.

Q. Did you need a laboratory as extensive as Mr. White's in order to do the work that the Bureau of Forensic Ballistics was set up to do?

A. No, we didn't, because you see, White's work is in a different field, a collateral field. White's resources put him in a position to do all this computation work in criminal cases, which he does not do.

I have frequently been requested since I went back on active duty many years ago to take criminal cases and I will not, because I feel that my military status would make it very embarrassing for me to go into such an enterprise and on many occasions I have tried to get the White Company to accept a criminal case and they won't do it.

They have the resources, they have a comparison microscope and have the photographic equipment, but they prefer to do developmental work in the field of small arms, developing a new type of cartridge or improving on an old type or testing a new type of weapon to determine whether the pressures developed by the load are within normal limits and safe limits and so forth.

The work, as I say, although collateral, is not identical, and in the crime laboratory it doesn't need all the equipment that they have.

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Testimony of E. W. Kronbach

[Tr. 40]

CROSS EXAMINATION

By Mr. KENNEDY:

Q. Mr. Kronbach, when was this work done for you by White, what year was that, if you know?

A. As I recall, it was late 1940 or early 1941, we put this in.

Q. Do you recall what you paid Mr. White for the service?

A. We paid comparatively little. I don't recall what the instrument was, but I know this, that they came over every time we called them to re-adjust or make a change here and there. I think a good deal of that time, I think none of that time was paid for. I know they never billed us and the only thing they billed us was the original instruments, I think. We bought one in 1941 and one a short time later.

Q. Do you know whether those instruments were billed to you, to the White Company, or what?

A. I wouldn't know that. I know they didn't make much money on it.

Mr. KENNEDY: That's all.

Mr. CLYNE: That's all, thank you very much.

• • • • •

Testimony of Henry P. White

[Tr. 71]

CROSS EXAMINATION

By Mr. KENNEDY:

• • • • •

[Tr. 76-81]

Q. In 1938 you actually received the corpus of this?

A. In 1939.

Q. Half or the full corpus?

A. Half the corpus.

Q. Mr. White, you have never made a profit, have you, from this operation of the laboratory?

A. No, sir.

Q. Do you have any recollection of the amounts of resources that you had between 1938 and the present time?

A. No, sir; I don't have my figures at hand, I'm sorry.

Q. You do have such figures?

A. I do not have them.

Q. I mean, you do have them someplace?

A. Well, I rather imagine back in some file box, we've got them.

Q. Would about $5,000 be the amount of loss in 1938?

A. I'm sorry, I can't answer that, I really don't have any recollection of it.

Q. In the years 1948 and 1949, the tax returns, Exhibits 4 and 5, your losses were approximately $18,000?

A. Yes, sir, between $18,000 and eighteen-five.

Q. For each year, were your losses earlier than 1948 less or greater than that amount, that is, 1947 and earlier years?

A. My recollection was that they were less, but how much less they were, I don't recall.

Q. According to Exhibit 5, which is your joint income tax return of you and your wife for the year 1948, you had gross income from the operation of the H. P. White Company of

$730.10. Now, do you recall from what source or sources that $730.10 was made up?

A. I'm just trying to remember back now.

Q. Well, perhaps—let me again refresh your recollection—

A. Thank you.

Q. My records show here that from the Franklin Stone Ware Velocity Test Cartridges you received $24, do you recall that?

A. Vaguely.

Q. Would you know how much time was spent by that by either you or Mr. Munhall or some other employee of yours that made the test? If you don't remember specifically from your experience, would you be able to recall how much—

A. As I recall that particular job, I rather imagine it took up in the neighborhood of three hours to perform that particular test.

Q. I also have a record you received $25 from the Liberty Mutual Insurance Company for the preparation of a report whether a rifle was faulty and caused an injury to a hunter, that was in 1948.

A. No, I don't recall. They frequently call us and ask our opinion on that as to the probability of their liability under some particular insurance clause or something like that.

Q. Would that require the service of either you or Mr. Munhall?

A. Yes, it would.

Q. About how long would it take you to undertake such a test?

A. Well, that particular item there, I don't imagine probably wasn't even testing. I don't recall a particular item itself. It most likely was a conference.

Q. A conference which might have taken an hour or less?

A. Probably met for a couple hours or something like that.

Q. It says, "Preparation of report." You wrote a report on it?

A. Well, I don't recall it.

Q. Well, how long do your reports on such a matter take?

A. Well, that kind of question is like asking how long is the tail of a dog? You don't know.

Q. It was only $25, you know.

A. Well, it evidently was.

Q. Then you received $14.90 from the sale of surplus cartridges. I don't suppose you would remember that.

A. Well, we would have quite a surplus of collectible material that we were endeavoring to realize money on, so that we wouldn't have to care for them. They were of no further use to us, so we sold them.

Q. Then my records show that you received $7 from the Cleveland Skating Club for preparation of special blanks for some ice review.

A. Yes, I recall that.

Q. How long did it take to prepare the blanks?

A. About half an hour.

Q. Did you prepare them?

A. No.

Q. Did Mr. Munhall prepare them?

A. Either him or one of the assistants.

Q. I see. You have $10 for consultation on whether your services would be valuable to a murder trial. Do you recall that?

A. No, I don't. Mr. Munhall took most of the legal phase of the work. I have qualified, of course, before the State of Ohio, as an expert in the line of mechanical engineering. He has handled most of the identification work.

Q. Then I have a fee here that says, $16.20 for sale of surplus books You were selling books on occasions?

Q. Yes, I have. I have mentioned earlier in the testimony we acquired a tremendous mass of material immediately following the war, one of the largest bulk of it, some 5 tons of it, as a matter of fact, including books and cartridges and pertinent mechanical portions of guns, we purchased from a chap on the West Coast and we catalogued that stuff and we incorporated into our reference collection what was needed and what was not needed we disposed of as the occasion would permit. We didn't catalogue it for general sale, because frankly, it would have been too long, a tedious

job, but when some people of associated interest would come in and there was a surplus, we would say, "Take what you want," and it was that kind of a transaction.

• • • • •

[Tr. 91-93]

Q. What is its source of income?

A. Primarily the source of income is from its annual subscriptions. I believe it's $5 a year now. Maybe it's four, but I believe it's $5 a year now. Of course, they have a good many life members and they are the only ones entitled to a vote at the annual meeting. It is very similar to other national organizations encompassing other lines of endeavor.

Q. That $5 fee, what cost does that defray for the American Rifle Association, does that entitle the member to a magazine?

A. It entitles him to a magazine, it entitles him to a consideration of questions he might send to their technical department regarding his weapons or ammunition or closely allied items. It also entitles him to a certain amount of information about gun and game laws and so on, some of the finer interpretations thereof. It entitles him to participate in a great many of their actual target matches and it also entitles him, and this is a vague benefit and one which I am not entirely in sympathy with, through the Director of Civilian Marksmanship of the United States Army, members, and only members alone of the National Rifle Association may purchase through the Director of Civilian Marksmanship rifles and components for the purpose of promoting marksmanship in the United States.

Q. $5 is used for the purpose of defraying costs of membership?

A. Yes.

Q. You don't know if they have any trust funds set up?

A. They have several trust funds set up.

Q. Without going into the details, do you happen to know the amount of the total assets of the association?

A. No, I don't know that, I know the director of that association.

Q. Do you know whether they would be able to purchase your organization and pay back your investment?

A. Well, as I say, I don't know. There has been no amount mentioned.

• • • • •

[Tr. 102]

RECROSS-EXAMINATION.

By Mr. KENNEDY:

• • • • •

[Tr. 104-106]

Q. Do you recall what your returns were in 1950 from the operation of the H. P. White Company?

A. No, sir; I do not.

Q. Would about $20,000 be close to that loss?

A. I don't recall the figures. The figures are entirely out of my head.

Q. But you did have a loss?

A. Yes, sir; we did.

Q. About the same as the amount you lost in 1948 and 1949?

A. I don't recall.

Q. Do you recall what your loss was in 1951?

A. No, I don't.

The CLERK: Offered for identification Exhibit D.

(Thereupon, the document above referred to was marked Respondent's Exhibit D.)

Q. I show you, Mr. White, what has been marked as Respondent's Exhibit D, and I ask you if you can identify that. Is that your joint income tax return for the year 1951?

A. Yes, sir.

Q. I call your attention to Schedule C on Page 2 of that return, entitled, "Profit or Loss from Business or Profession," and I ask you to read the resultant figure.

A. Where is that?

Q. Schedule C.

A. Net profit or loss, Line 4, less Line 5, close parentheses $33,369.98.

Q. That was loss for that year, is that correct?

A. I assume that it was, I am not too very good at figures.

Q. Well, that figure of $33,000 is in parentheses.

A. May I ask, may I consult my counsel about this? I don't know what losses you are talking about, sir.

Mr. CLYNE: May I take it?

The WITNESS: Yes, surely.

Mr. CLYNE: There are your losses, that $33,000 figure. Will you state your loss for counsel?

The WITNESS: $33,369.98.

By Mr. KENNEDY:

Q. That was the loss on the operation of the H. P. White Company for the year 1951, was it not?

A. Yes, that was incurred due to the fact that we were getting ready to move to Bel Air.

Q. Just one more question, Mr. White. You have testified you are doing better this year, in 1953?

A. Yes.

Q. You do have records, don't you?

A. Yes, sir.

Q. You don't wish to put any of those records in to show how much better you are doing?

A. No, I don't. I believe we have taken in about twice as much as we did last year, but I think we have done maybe even a little bit better than that, I don't know.

Q. Do you have those records with you?

A. No, I do not.

Q. Didn't you think they might be helpful in this trial?

A. Well, frankly, to be frank with you, I do deal with mathematics all the time, but I'm afraid these tax matters rather confuse me. Perhaps I should have brought them. If I should have and haven't, I'm awfully sorry.

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In the Supreme Court of the United States

OCTOBER TERM, 1955.

No. 841.

HENRY P. WHITE, and
ESTATE OF NANCY A. WHITE, deceased,
T. LEO SULLIVAN, ADMINISTRATOR, *c.t.a.*,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI
To the United States Court of Appeals
For the Sixth Circuit.

THOMAS V. KOYKKA,
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April 5, 1956.

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HENRY P. WHITE, and
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T. LEO SULLIVAN, ADMINISTRATOR, *c.t.a.*,

Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR WRIT OF CERTIORARI.

To the Honorable Earl Warren, the Chief Justice of the United States, and the Associate Justices of the Supreme Court of the United States:

Petitioner, Henry P. White, and the Estate of Nancy A. White, T. Leo Sullivan, administrator *c.t.a.*, pray that a writ of certiorari issue to the United States Court of Appeals for the Sixth Circuit to review the judgment entered by that court in cause No. 12,445.

OPINIONS BELOW.

The opinions of the courts below may be found:

Opinion of the Tax Court, by Judge Opper, is reported in 23 T. C. 94, and is printed in the appendix hereto, page 21.

Opinion of the United States Court of Appeals for the Sixth Circuit (Judges Martin, Miller and Stewart) is reported in 227 F. 2d 779, and is printed in the appendix, page 28.

JURISDICTION.

The judgment presented for review is dated and was entered December 16, 1955; petition for rehearing was denied January 13, 1956.

This Court has jurisdiction to review under 28 U. S. C. § 1254(1) upon petition for certiorari filed within the 90 days prescribed by 28 U. S. C. § 2101(c).

QUESTION PRESENTED.

The question presented is:

Whether the Court of Appeals has established an erroneous standard for determining what is a "trade or business" under § 23(a)(1)(A) of the Internal Revenue Code of 1939 [a statute which continues as § 162(a) of the present Internal Revenue Code of 1954].

STATUTE INVOLVED.

Decision in this case turns upon the proper construction of a "trade or business" under § 23(a)(1)(A) of the Internal Revenue Code of 1939, which reads:

"SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) EXPENSES.—

(1) TRADE OR BUSINESS EXPENSES.—

(A) IN GENERAL.—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, * * *." [1]

---

[1] The same provision continues in the present Internal Revenue Code of 1954, § 162(a), in the following form:

"There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, * * *."

STATEMENT OF CASE.

The taxpayer, Henry P. White (who, with his wife, Nancy A. White, now deceased, filed the joint income tax returns for the years 1948 and 1949, here in question) operates, as an individual proprietor, a ballistics laboratory engaged in testing, research and development of firearms and ammunition.

—The Issue.

The courts below—because they applied an erroneous standard—held the laboratory was not operated with "a profit motive" and was not a "trade or business."

Both courts so held on the ground there was no:

> "reasonable possibility of the laboratory's ever generating gross income sufficient to offset its expenses." (Court of Appeals, Appendix, p. 29; see also, Tax Court, Appendix, p. 25.)

Both courts allowed deduction of the expenses of operating the laboratory up to the extent of the income received in each of the two years in question; they disallowed all expenses incurred in excess of the income received in those years.

Both courts thus made the success of the venture control the extent to which expenses shall be allowed under § 23(a)(1)(A) of the Internal Revenue Code of 1939 [and § 162(a) of the present Code].

This gives to an important statute, which affects substantially every business return filed, a strange and alarming turn.

—How Issue Arises.

To measure the mischief the decision below does to the statute, and to gauge its consequences on the reading of revenue laws, it will be useful to note what, in the Sixth Circuit, no longer qualifies as a "trade or business."

(i) Nature of the Laboratory.

The laboratory was established in Cleveland in 1936 by Henry P. White, then a young man of 27, two years out of Cornell, where he had received his engineering degree in 1934. (Tr. 54, 71, 76.)

During all of the intervening years the taxpayer has continued the operation of the laboratory. He has enlarged its facilities and services. In 1953, outgrowing the Cleveland quarters, and for better access to army and navy proving grounds and the New York and New England arms manufacturing district, the taxpayer moved the laboratory to Bel Air, Maryland, where it now is located. (Tr. 53-54, 114.) The laboratory now is equipped to do not only research and development in small arms and ammunition, but also mechanical development, testing and analysis not directly allied with the field for which the laboratory was established. (Ex. 1, Tr. 52, 62.)

(ii) What the Laboratory Does.

Whether the laboratory is a "trade or business," the taxpayer believes, must, under the statute, turn on what it does and not on anyone's prophecy as to its "reasonable possibility" of earning a profit.

These—and there is no dispute about this—are the activities in which the laboratory engaged:

Published three technical books based on research done by the laboratory. The books, although they have enjoyed only limited sale because of their specialized nature, are important contributions, and are a source of continuing income. (Tr. 89.) They are:

Catalog of Cartridge Manufacturers and Base Marks, published in 1944, sold at $50 per vol-

ume to the armed forces and to law enforcement agencies including the FBI. (Tr. 60, 94-95.)

Center Fire Metric Pistol and Revolver Cartridges, published in 1948, and publicly sold on a royalty basis. (Ex. A, Tr. 85, 86, 89, 96.)

Center Fire American and British Pistol and Revolver Cartridges, published in 1950, most of the work for which was done in 1947 and 1948, and likewise publicly sold on a royalty basis. (Ex. B, Tr. 86-87, 96.)

Published numerous magazine articles and technical papers (Ex. 1, Tr. 52, 62, 87-88) for compensation. (Tr. 89.) The revenue from these sources was $625 in 1948 (Tr. 81) and $825 in 1949. (Tr. 89.)

Held contracts with the Navy, involving both guns and ammunition (Tr. 54, 61, 99, 102-103), and with the Treasury in identification and evaluation of seized illegal weapons (Tr. 54-55, 94). The laboratory is, and since 1939 has been, designated as a research laboratory by the Treasury under § 4(5) of the Federal Firearms Act, 15 U. S. C. § 904. (Ex. 2, Tr. 54, 55, 56, 63.)

Performed services for the National Rifle Association, a national organization with 300,000 members. (Tr. 20, 56, 91.)

Performed services for individuals and companies in connection with litigation. (Tr. 57, 78, 80, 89.)

Rendered services to "hand loaders," small arms enthusiasts who prefer to load their own ammunition for greater accuracy (Tr. 19-20, 28-30, 42-

45, 47-48, 61), of whom, it is estimated, there are 20,000 in the country. (Tr. 30.) This is a group which appears to be growing in numbers (Tr. 28-29, 44, 61.)

Negotiated with the National Rifle Association for enlarged services to its members in examination and certification of arms akin to the work done by Good Housekeeping magazine in connection with its seal of approval. (Tr. 63-64, 101-102.)

Performed ballistics tests and analytical work for private industry (Tr. 78, 81, 89), developed highly useful tests of armor plate for tank manufacture (Tr. 36-37) and engaged in work for Remington Arms Company. (Tr. 93.)

Solicited business. (Tr. 98-99, 111, Ex. 1, Tr. 52, 62.)

Negotiated with a sports magazine for purchase of the laboratory's services. (Tr. 102.)

Prepared the lessons in firearms identification used by the Institute of Applied Science in Chicago, graduates of which staff 800 law enforcement identification bureaus. (Tr. 49-51.)

Plainly, by all indicia, the laboratory is a "trade or business."

But, it did not earn a profit.

It had income, $730.10 in 1948, and $2,502.26 in 1949.

But it did not—in the view of the courts below—have enough income.

The courts below, therefore, allowed deduction of expenses only to the extent of the income earned.

—Basis of Decision Below.

The Tax Court "commended" the taxpayer "for the devotion of his time and effort in a worth-while endeavor" (Appendix, p. 27) and for the services rendered "not only to industrial producers but to local and even Federal government." (Appendix, p. 29.)

So did the Court of Appeals. (Appendix, p. 29.)

But both courts ruled the laboratory could not be a "trade or business" because, in their view, it never could be operated profitably.

The taxpayer did not share this belief. Before starting the enterprise, the taxpayer consulted eminent and qualified persons concerning the need for the services of such a laboratory and to see "what business might be expected." (Tr. 66.) He intended "to sell * * * services to the public" (Tr. 66)—and did, as has been seen—and said he "went into this to make a profit." (Tr. 68.) In 1953, confident of success, he established a vastly expanded plant in Bel Air, Maryland, involving a capital investment of $300,000. (Ex. 1, Tr. 52-53, 62, 114.) He believed he would be in the black in 1954. (Tr. 100.)

Because the taxpayer did not in fact turn a profit, and because the laboratory in the Tax Court's view "was not capable of producing income in sufficient amount to offset the usual expenses" (Appendix, p. 25), the Tax Court held the taxpayer (Appendix, p. 27):

> "could not in good faith reasonably have expected or intended to operate his ballistics laboratory profitably."

The Sixth Circuit agreed. It held the laboratory offered no "reasonable possibility" of profit. (Appendix, p. 29.)

This makes success the test.

The statute does not so provide.

REASONS FOR ALLOWANCE OF WRIT.

The Court should grant the writ to restore to an important revenue statute the meaning, language, context, history and common sense demand.

I. SIXTH CIRCUIT IS IN CONFLICT WITH ANOTHER CIRCUIT.

The command of the statute, § 23(a)(1)(A) of the Internal Revenue Code of 1939 (as well as of the present statute, § 162(a) of the 1954 Code) is that "there shall be allowed" as deductions in computing income subject to tax:

> "All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business * * *."

That is all there is.

The statute does not say expenses shall be allowed only to the extent of the income earned, or only if there is (Appendix, p. 29):

> "reasonable possibility of * * * generating gross income sufficient to offset * * * expenses."

The condition the Sixth Circuit has read into the statute is in conflict with the construction put upon the statute by the Court of Appeals for the District of Columbia in *Doggett v. Burnet* (App. D. C., 1933), 65 F. 2d 191.

The court in *Doggett* had before it § 214(a)(1) of the Revenue Act of 1926. It read precisely as does the present statute.[2]

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[2] The statute in *Doggett*, § 214(a)(1) of the Revenue Act of 1926, provided, as does the statute here in question (65 F. 2d at 193):

> "In computing net income there shall be allowed as deductions: (1) All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, * * *."

In *Doggett*, the taxpayer, while in England, became interested (p. 192) "in the writings and teachings of Joanna Southcott, a religious teacher and prophetess, who died in 1814." The taxpayer (p. 192):

> "read the sixty-five works of Joanna Southcott which were in the British library. The remaining works of Joanna Southcott are supposed to be sealed in an ark in the custody of the British Parliament, and her followers believe that the ark will be opened by the twenty-four bishops of the House of Lords. The ark was to be opened in 1914, or whenever the nation's troubles demanded that it be opened."

Miss Doggett returned to this country and undertook the publication of the works of Joanna Southcott (p. 192):

> "for the benefit, as she alleges, of the American people, and also with the expectation of deriving a large profit from the sale of the books after the ark is opened."

She spent $38,000 on the task. But, as the court noted (p. 192):

> "The sale of the books has been limited, and about 200,000 are stored in San Diego."

The Board of Tax Appeals denied to Miss Doggett deduction of expenses incurred in the prosecution of the work on the "reasonable possibility" of profit reading of the statute the Sixth Circuit here has espoused. The Board (p. 193):

> "denied the deduction on the ground that appellant has failed to show that the alleged business of publishing and marketing the books of Joanna Southcott has been profitable, or that there is prospect that it will be profitable."

The Court of Appeals for the District of Columbia reversed. It rejected the construction given the statute by

the Board—and here adopted by the Sixth Circuit. The court said (p. 193):

> "We think this is too severe a limitation to be placed upon the determination of what constitutes a business within legal contemplation."

The court ruled (p. 193):

> "to hold that the legal test of whether or not an occupation constitutes the doing of business, depends on whether it is profitable or has prospects of being profitable, is too restrictive an interpretation of the revenue act."

The "better test," the court went on to say (p. 194):

> "is whether or not the person engaged in a legitimate enterprise shows a willingness to invest time and capital on the future outcome of the enterprise, whether it be successful or unsuccessful."

1. Sixth Circuit Imported Profit Test from Statute Not Controlling Here.

It is easy to see how the Sixth Circuit fell into its profit-test rendering of the statute.

The court quarried the profit-standard from another statute.

And then it imported that standard into the statute the court had before it.

The Sixth Circuit was led into this, taking from one statute and adding to another, by the Tax Court. The Tax Court, as its opinion shows, relied principally on *Thacher v. Lowe* (S. D. N. Y., 1922), 288 F. 994.

But *Thacher*, as the opinion shows, turned on a different statute. It dealt with a statute which, unlike present § 23(a)(1)(A), concerned, as the court pointed out (p. 994):

" 'lawful business carried on for gain or *profit.*' " [3]

The profit-standard which was in the statute the court had before it in *Thacher* has its counterpart in § 23(e)(2) of the 1939 Code (and § 165(c)(2) of the present Code) which allows deduction, in the case of individuals, of "losses":

> "if incurred in any transaction entered into *for profit* * * *."

The fact that Congress wrote the test of *profit* into one statute is no ground for importing it, as both the Tax Court and the Sixth Circuit here have done, into another statute where Congress omitted it.

As is pointed out in 4 Mertens, *Law of Federal Income Taxation* (Zimet & Diamond Revision) § 25.15:

> "It is necessary but not easy to distinguish between losses and business expenses. The necessity of such distinction arises from the fact that the Code contains separate provisions dealing with deductions for losses and those dealing with deductions for business expenses."

The Sixth Circuit's failure to discriminate between statutes is evident from the fact that when the court, in Note 1 of its opinion, quoted the statute it was construing (Appendix, p. 28), it *omitted* entirely § 23(a)(1)(A)—the statute which controlled the case before it—and quoted instead § 23(e) dealing with losses in a "transaction entered into *for profit.*"

The Sixth Circuit's failure to discriminate is evident also from its reliance not only on *Thacher* but on *Ewing v. Commissioner* (2 C. A., 1954), 213 F. 2d 438, which likewise dealt, not with the statute here in question, but with

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[3] Emphasis supplied throughout the brief except as otherwise noted.

§ 23(e)(2), allowing losses from a "transaction entered into *for profit.*"

The Sixth Circuit has fed into the statute dealing with the expenses allowed a "trade or business" a condition Congress lodged in a different statute.

Such construction by osmosis this Court has condemned. *Higgins v. Commissioner* (1941), 312 U. S. 212, 217; *United States v. Pyne* (1941), 313 U. S. 127, 131.

2. Sixth Circuit's Construction Gives Statute Alarming Turn.

The "reasonable possibility" of profit test the Sixth Circuit has written into the statute gives the statute an alarming turn and almost certainly violates congressional policy:

—(a) Decision, Not Statute, Lets Commissioner Bar Venture if He Thinks It Too Costly.

Congress could not have intended to empower either Commissioner or the courts to allow or disallow expenses according to their belief concerning the "reasonable possibility" of profit in a "trade or business."

The law, as written, leaves it, not to the Commissioner or the courts, but to the taxpayer to say how long he shall persevere in what to others may appear a fruitless effort.[4] It is well to bear in mind, as is pointed out by Professor Lewis A. Froman, *Principles of Economics,* Revised Edition, 1946, that (p. 544):

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[4] In the present case, for example, Col. Calvin H. Goddard who organized the Bureau of Forensic Ballistics in New York in 1924 (Tr. 10) and the Crime Detection Laboratory at Northwestern University in 1930 (Tr. 13) testified that after the *Saturday Evening Post* published two 10,000 word articles on his laboratory in 1925 he expected to be overwhelmed by business. (Tr. 24.) The revenue for the entire year following the publication turned out to be $50. (Tr. 24, 32.)

"it is the rule, rather than the exception, for a relatively large number of businesses to operate at a loss each year."

Professor Froman points out, from a study of corporate returns as reported by the Treasury (p. 545) "For the period 1922-29, which is usually considered to be one of at least average, if not glowing, prosperity," that (p. 545):

"approximately *40 per cent of all corporations reported no net income* during each of the years." [5]

The statute does not demand success and the court had no right to say it does.

—(b) Decision Short-Circuits "Hobby Loss" Statute.

The Tax Court and the Sixth Circuit appear to have treated the laboratory as if it were a hobby. Treating the laboratory as a hobby, which it most surely is not, the decision still would be wrong under the hobby loss statute which Congress wrote into the law in the Revenue Act of 1943. It is § 130 of the 1939 Code (and § 270 of the present Code). It says that if deductions exceed income by more than $50,000 "for five consecutive taxable years" the deductions "shall be allowed only to the extent of $50,000 plus the gross income * * *."

Of this statute Randolph E. Paul, in *Taxation in the United States,* says (p. 368):

"One item of intense debate on the Senate floor was a Committee 'anti-hobby' amendment, popularly known as the 'Marshall Field amendment,' which provided for a restriction on the deduction of losses in a trade or business where the losses continued for five consecutive years. Under this provision, as finally enacted, loss deductions were restricted to

[5] The italics are Professor Froman's.

$50,000 a year where the taxpayer's losses exceeded that amount for the five years. The provision was not effective for any taxable years beginning prior to January 1, 1944. Democratic Senator Clark of Missouri had been for this amendment because Marshall Field had been 'engaged in the activity of starting newspapers and other publications around over the country for the purpose of influencing and, as some of us think, corrupting, the public mind, simply as a device to reduce his income taxes.' The Senator changed sides when he learned from Senator Barkley that the amendment would not apply to Field because he had incorporated his newspaper enterprises, and would apply principally to persons like his late father-in-law who had lost money in the enterprise of improving the breed of Guernsey cattle. Republican Senator Danaher continued his floor fight for the amendment in a debate which exhibited great learning on the subject of breeding cattle. Senator Barkley warned that the amendment would affect oil operators and others who had losses in the early years of operation of a risky business, and Democratic Senator Elmer Thomas of Oklahoma feared for persons like Henry Ford who had daringly experimented with soybeans. However, the Senate voted favorably on the amendment 37 to 26.

Later, in the House debate on the conference report Democratic Representative Cochran of Missouri pointed out that the amendment put a penalty on progress as well as science. 'Great benefits accrue from hobbies,' said the Congressman, who went on to cite cases in support of this generalization. In addition to 'fine beef and dairy cattle,' the 'finest breed of hogs, chickens, and other agricultural products, the finest thoroughbred horses in the world,' there were Thomas Edison and his hobbies; moreover, the Diesel engine had originated in some hobby financing by Adolphus Busch and a Mr. Sulzer of Switzerland."

If the "hobby loss" statute controls, the decision below is manifestly wrong because the taxpayer's expenses did not exceed the limit fixed by the statute.

But if the "hobby loss" statute does not control, it is itself a token of congressional policy which the decision at hand frustrates.

In short, this statute visits on the individual whose "trade or business" runs in the red by more than $50,000 for five years an additional penalty for his want of success. Here the court has visited on this taxpayer the same penalty but without allowing to the taxpayer the deductions the statute says he shall have.

3. Sixth Circuit's Decision Is Hostile to Reading Given Statute in Other Circuits.

The Sixth Circuit's construction of the "trade or business" provision of § 23(a)(1)(A) is also at odds, although short of square conflict, with the reading given that statute in the Third and Fourth Circuits. For example:

Cecil v. Commissioner (4 C. A., 1939), 100 F. 2d 896, involved denial by the Board of Tax Appeals of deduction for expenses incurred by the taxpayer in operating her ancestral home, on a very large estate in Buncombe County, North Carolina, as a museum, because the Board, *Cornelia Cecil* (1938), 37 B. T. A. 904, had found that (p. 914) "all petitioner intended to do was to try to break even." The Fourth Circuit reversed. Although the court did not wholly exclude the element of profit, the court said (100 F. 2d at 901) "In deciding the case on the view that the enterprise could not as a matter of law be considered a 'business' unless the taxpayer intended and ex-

pected a net profit, we think the Board adopted too narrow a concept of the word 'profit' * * *." The court considered it enough that the taxpayer put the property (p. 899) "to the use and enjoyment of the public for compensation * * *."

Whitney v. Commissioner (3 C. A., 1934), 73 F. 2d 589, and *Commissioner v. Widener* (3 C. A., 1929), 33 F. 2d 833, both held the operation of racing stables, which never had shown a profit, constituted a "business." In *Whitney*, rejecting the conclusion of the Board of Tax Appeals that (73 F. 2d at 592) "the pleasure in owning a stable was the primary interest of the petitioner," the Third Circuit reversed, noting that, as here, the enterprise (p. 591) "was run on a business basis."[6] In *Widener* the court affirmed the Board's holding that the operation of the stable was a business even though (33 F. 2d at 833) "petitioners were wealthy enough to afford a hazardous occupation in which they found pleasure despite discouraging losses."

Plainly, unanimity of view on the meaning of "trade or business" does not prevail in the circuits.

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[6] The White Laboratory operated on regular hours, 8 a.m. to 4:30 p.m. daily (Tr. 56-57), employed subordinates (Tr. 83-84), used time cards (Tr. 57), maintained a cost system. (Tr. 57.) Except for the four years he was in military service when the laboratory was operated by subordinates (Tr. 68) and except for time required for personal matters, the taxpayer devoted all of his time to the operation of the laboratory. (Tr. 66.)

II. THIS COURT'S DECISIONS LEAVE QUESTION UNSETTLED.

This Court has four times had before it the question of what is a "trade or business" under this statute.

The decisions leave the controlling test in doubt.

The cases in this Court where the question has arisen are:

Deputy v. du Pont (1940), 308 U. S. 488, where five Justices assumed, for purposes of decision, but found it unnecessary to decide, that the taxpayer's activities in buying and selling stock to aid his corporation constituted a "trade or business"; two Justices concluded this was not a "trade or business" and two Justices believed it was a "trade or business."

Higgins v. Commissioner (1941), 312 U. S. 212, where the Court held that management of one's own investments is not a "trade or business."

United States v. Pyne (1941), 313 U. S. 127, where the Court reversed the Court of Claims for want of adequate findings to show whether executors in carrying on the affairs of an estate were or were not engaged in a "trade or business."

McDonald v. Commissioner (1944), 323 U. S. 57, where the Court was unable to muster a majority for any one view. The Court divided as follows:

Four Justices (Mr. Justice Frankfurter, Mr. Chief Justice Stone, Mr. Justice Roberts, and Mr. Justice Jackson) concluded that the taxpayer, a judge, was engaged in a "trade or business" within the meaning of the statute, but that he

could not deduct his campaign expenses because they (p. 60) "were not expenses incurred in being a judge but in trying to be a judge for the next ten years."

One Justice (Mr. Justice Rutledge) concurred in the result without joining in the opinion.

Four Justices (Mr. Justice Black, Mr. Justice Reed, Mr. Justice Douglas, and Mr. Justice Murphy) did not express a view on "trade or business," but thought the taxpayer ought in any case to be allowed his deductions under another statute as expenses incurred (p. 65) "for the production * * * of income."

It is apparent no certainty of rule has emerged. This, no doubt, accounts for the diversity of view in the lower reviewing courts.

The nearest that has emerged from these cases in the form of a standard to set apart that which is a "trade or business" from that which is not, is the rule suggested by Mr. Justice Frankfurter and Mr. Justice Reed in their concurring opinion in *Deputy v. du Pont* (1940), 308 U. S. 488, that (p. 499):

> " 'carrying on any trade or business,' within the contemplation of § 23(a), involves holding one's self out to others as engaged in the selling of goods or services."

Under this test the laboratory clearly is a "trade or business."

The rule thus suggested in the *Deputy v. du Pont* concurring opinion is the rule adopted by the Third Circuit in *Helvering v. Wilmington Trust Co.* (3 C. A., 1941), 124 F. 2d 156, 158-160, reversed on other grounds and on another point in *Wilmington Trust Co. v. Helvering*

(1942), 316 U. S. 164, without consideration of this question.

Whatever may be the correct rule most surely should be settled.

CONCLUSION.

Not only does the decision below do grave injustice to a worthy citizen who has deserved well of his nation, but it gives to a statute which affects every "trade or business" in the land an alarming meaning by reading it as a grant to Commissioner and the courts of a power Congress surely never intended and certainly never bestowed.

The writ should issue.

Respectfully submitted,

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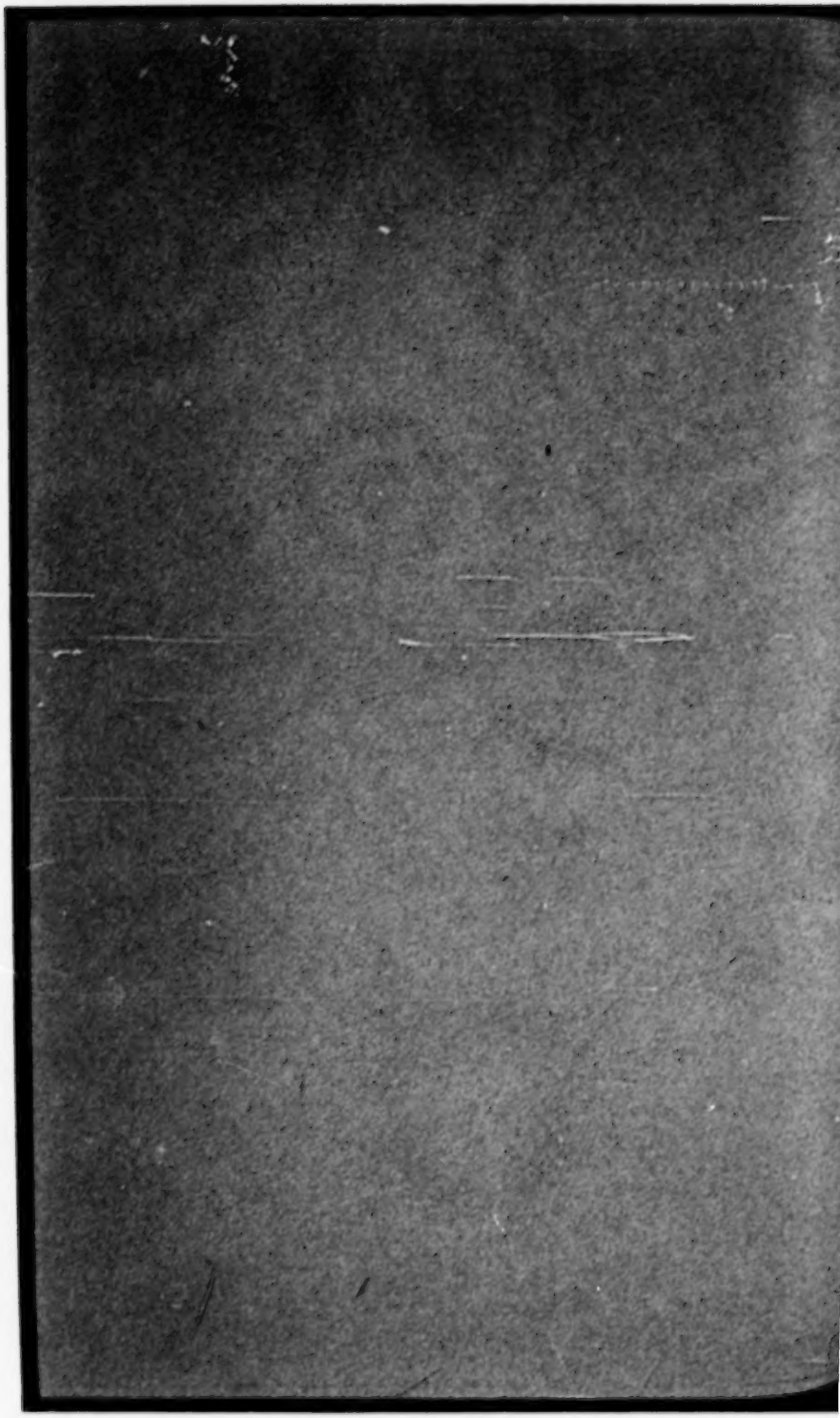
April 5, 1956.



APPENDIX.

FINDINGS OF FACT AND OPINION OF THE TAX COURT (23 T. C. 94).

(Filed October 19, 1954.)

A ballistics laboratory, owned by petitioner, and operated consistently at a loss *held*, on facts, not a business carried on for profit and the excess of expenditures over income not deductible as either a loss or business expense under section 23, Internal Revenue Code of 1939.

Respondent determined deficiencies in income taxes of petitioners for the calendar years 1948 and 1949 in the amounts of $1,088.51 and $10,014.28, respectively. Petitioners, in addition to resisting the deficiency determinations, claim that, if they prevail, there has been an overpayment of income taxes for the calendar year 1948 due to certain conceded arithmetical errors.

The question presented is whether petitioners were entitled to deduct under section 23 expenditures claimed to be ordinary and necessary expenses of a trade or business.

FINDINGS OF FACT.

[1]* Petitioners, Henry P. White and Nancy A. White, husband and wife, filed joint income tax returns for the calendar years 1948 and 1949 with the collector of internal revenue for the eighteeenth district of Ohio.

[2] On March 19, 1951, petitioners filed with respondent a claim for a refund of $7,671.05 for the year ending December 31, 1948.

---

* Bracketed numbers supplied by counsel.

[3] Petitioner Henry P. White, hereinafter sometimes called petitioner, was graduated from Cornell University in 1934 with a degree in engineerng and was licensed as a mechanical engineer by the states of Ohio and Maryland. He sold automobiles for the remainder of 1934 and was employed by the Central National Bank of Cleveland in 1935. He also became the sole beneficiary in 1935 under a trust of approximately $2,000,000.

[4] In 1936, petitioner opened a ballistics laboratory in Cleveland, Ohio, specializing in guns and ammunition research, and in such work employed the services of subordinates. Until petitioner went into the armed service this laboratory had continued to function under his direct supervision. During petitioner's absence, his first assistant operated the laboratory. When petitioner returned from the service, he again took over direction and management of the laboratory and it has continued to function under his supervision through the years in question. This research laboratory is now located at Bel Air, Maryland, in proximity to Army and Navy Proving Grounds.

[5] Operation of the laboratory included the preparation and publication in 1948 of a book entitled "Centerfire Metric Pistol and Revolver Cartridges," and research preparatory to the publication in 1950 of a second book entitled "Centerfire American and British Pistol and Revolver Cartridges," but income realized from sales of the first book during the years in controversy did not exceed $500. No attempt was made in the years in issue to segregate those expenditures properly attributable to producing the copyrighted publications and laboratory research library data, although it appears that most of the endeavors of petitioner and his associates were connected with the named activities.

[6] During the years involved, approximately one-half of petitioner's time was devoted to the preservation and conservation of his estate. His secretary expended all of her time upon petitioner's personal affairs. The general manager of the laboratory spent half of his time on the personal affairs of petitioner. An arbitrary method of allocating the latter's salary according to the time spent on petitioner's personal affairs and the laboratory endeavors was used.

[7] Petitioners' joint income tax returns for 1948 and 1949 reported the following income and expense items in the operation of the ballistics laboratory resulting in net losses which were disallowed by respondent:

[8]

1948		
Income		$ 730.10
Expenses:		
Payroll	$15,462.53	
Office Supplies	1,900.49	
Shop & Laboratory Supplies	1,376.96	
Advertising	1,976.61	
Social Security	133.38	
Unemployment Compensation	66.70	
Workmen's Compensation	73.01	
Personal Property Tax	618.64	
Insurance (⅓)	181.62	
Telephone	458.94	
Burglar Alarm	447.30	
Utilities	680.79	
Cleaning	81.82	
Repairs	137.07	
Post Office Box	6.00	
Auto Expense	288.72	
Police Commissions	42.00	
Miscellaneous	242.51	
Legal	35.00	

Surety Bonds	53.00	
Depreciation	2,039.71	
	$26,302.80	
Less: Administration of investments	6,947.88	19,354.92
NET LOSS		$18,624.82

[9] **1949**

Income		$ 2,502.26
Expenses:		
Payroll	$19,104.61	
Shop and Laboratory Supplies	851.51	
Office Supplies	1,846.03	
Advertising	1,668.50	
Payroll Taxes	254.42	
Workmen's Compensation	95.55	
Fire Insurance (⅓)	202.65	
Other Insurance	124.50	
Burglar Alarm	453.60	
Telephone	477.51	
Light, Power and Water	774.09	
Cleaning	107.01	
Post Office Box Rent	6.00	
Auto Expense	297.32	
Repairs	256.67	
Miscellaneous	208.23	
Police Commissions	43.40	
Depreciation	2,342.06	
	$29,113.66	
Less: Administration of investments	8,090.38	21,023.28
NET LOSS		$18,521.02

[10] Of the $730.10 income received from the operation of the ballistics laboratory in the year 1948, $625 was

acquired in fees for writing articles for the National Rifle Association.

[11] The ballistics laboratory was of some service and benefit to a limited number of persons and organizations, but it was not capable of producing income in sufficient amount to offset the usual expenses. Petitioner has never made a profit from the operation of the ballistics laboratory; it has incurred losses in every one of the 17 years from its inception in 1936 to the time of trial in 1953. For example, petitioners' joint income tax return for the calendar year 1951 revealed that they suffered a $33,369 loss.

[12] Subsequent to the taxable years in question petitioner made a capital investment of $300,000 for the construction of a new ballistics laboratory in Maryland. In determining whether his new enterprise would be profitable petitioner has figured no amount for interest on this capital investment, nor has he figured any amount for the value of his own services for the years 1953 and 1954. Petitioner had no real expectation of any net income for years subsequent to those in issue.

[13] Petitioner did not operate the ballistics laboratory as a business or with the intent of making a profit during the taxable years 1948 and 1949.

[14] The expenditures claimed were neither ordinary and necessary expenses of carrying on a trade or business nor losses within the meaning of section 23, Internal Revenue Code of 1939.

OPINION.

OPPER, *Judge*: Whether the amounts presently in controversy are claimed as "losses" or as ordinary and necessary business expenses, the existence of a profit motive on

the part of petitioner is requisite.[1] The principle which we are now required to apply has been aptly stated by Judge Learned Hand sitting as a District Judge in *Thacher v. Lowe* (S. D., N. Y.), 288 F. 994, 995:

> * * * It does seem to me that if a man does not expect to make any gain or profit * * * it cannot be said to be a business for profit, and while I should be the last to say that the making of a profit was not in itself a pleasure, I hope I should also be one of those to agree there were other pleasures than making a profit. * * * it does make a difference whether the occupation which gives him pleasure can honestly be said to be carried on for profit. Unless you can find that element it is not within the statute, * * *.

Nor do we think it necessary that "pleasure" be equated with idleness or that financial return is the indispensable equivalent of public benefit. The gratification derived from an occupation worth doing, possibly beneficial to others and probably requiring long hours of arduous labor, must still not be confused with an intention to return a profit. We find no evidence here that petitioner did, or could in good faith, have had such an intention during the years in dispute.

Petitioner's independent wealth, the long history of losses,[2] and the entire disproportion of receipts to expendi-

---

1 "* * * An occupation or employment will not be excluded from the classification of business merely because it actually results in loss instead of profit; but it is essential that livelihood or profit be at least one of the purposes for which the employment is pursued, * * *" *Deering v. Blair* (C. A., D. C.), 23 F. 2d 975, 976. See also *Chaloner v. Helvering* (C. A., D. C.), 69 F. 2d 571, 572.

2 "* * * It would be specious to say that a vain hope that on some remote day a profit may result is enough to give the operation * * * the character of trade or business. It is far different from saying, as the Board and the courts have in other cases, that the fact of a loss does not deprive a business enterprise of its character as a business. * * *" *Louise Cheney*, 22 B. T. A. 672, 674.

tures[2] may not singly and individually be conclusive. But when considered together and coupled with the necessity of overcoming the burden of proof imposed upon petitioner, they lead us to the conclusion that as of the tax years before us, anyone of his intelligence, education and ability, with knowledge of the facts, could not in good faith reasonably have expected or intended to operate his ballistics laboratory profitably.

Such statements as the following from petitioners' brief are thus wide of the mark: "We * * * know the value of research and the many benefits that result from it." It may readily be granted that petitioner's work has been useful and perhaps unique; that he has rendered service not only to industrial producers but to local and even Federal government.

But when over a period of some 12 years the expenses of operation always exceeded the financial return, when in the period here involved the proportion of cost to income averages in the neighborhood of 12 to 1, when we know from the record that even in a subsequent year there was not only no profit but even an increased loss, it strains the credulity to conclude that the purpose of these activities was to earn money as contrasted with performing a public service.

Paraphrasing *Louise Cheney*, 22 B. T. A. 672, 674, petitioner's intention was not to run a business or make a profit but to obtain the personal gratification of fulfilling a recognized need. Petitioner is to be commended for the devotion of his time and effort in a worth-while endeavor.

---

[2] "* * * But if the gross receipts from an enterprise are practically negligible in comparison with expenditures over a long period of time it may be a compelling inference that the taxpayer's real motives were those of personal pleasure as distinct from a business venture, * * *" *Cecil v. Commissioner* (C. A. 4), 100 F. 2d 896, 899.

But this does not supply the missing element of profit motive.

This disposition renders unnecessary any consideration of respondent's alternative contention that the expenses must, in any event, be disallowed because to some undisclosed extent they resulted in the acquisition of capital assets.

Decision will be entered for the respondent.

OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT.

(227 F. 2d 779.)

(Filed December 16, 1955.)

Before MARTIN, MILLER and STEWART, Circuit Judges.

PER CURIAM. We are asked by the petitioners to reverse a decision of the Tax Court upholding the Commissioner's disallowance of certain deductions taken by the petitioner husband (herein called the "taxpayer"), and his since deceased wife in their joint income tax returns for 1948 and 1949. At issue is the question whether expenses incurred in the operation of a ballistics laboratory owned by the taxpayer were ordinary and necessary expenses of a trade or business or losses in a transaction entered into for profit, and thus deductible under Section 23 of the Internal Revenue Code of 1939.[1] The Tax Court held that they were not.

---

[1] Sec. 23 DEDUCTIONS FROM GROSS INCOME. In computing net income there shall be allowed as deductions: (a) [as amended by Sec. 121, Revenue Act of 1942, c. 619, 56 Stat. 798] *Expenses.*—(1) *Trade or business expenses.*— * * * (e) *Losses by Individuals.*—In the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—(1) if incurred in trade or business; or (2) if incurred in any transaction entered into for profit, though not connected with the trade or business; or * * *." (26 U. S. C., 1952 ed., Sec. 23.)

The taxpayer was graduated from Cornell with an engineering degree in 1934. Thereafter for a short period he sold automobiles and later worked in a bank. In 1935 he became the beneficiary of a large inheritance, and in 1936 opened a ballistics laboratory in Cleveland, specializing in guns and ammunition research. Subsequent to the taxable years involved a new laboratory was established in Bel Air, Maryland, at a cost of $300,000.

In 1948 the petitioner reported gross income from the laboratory of about $700 and expenses of about $19,000. In 1949 gross income of about $2,500 and expenses of over $21,000 were reported. The Tax Court found that the taxpayer did not operate the laboratory as a business or with the intent of making a profit during these years, and that its expenses were neither ordinary and necessary business expenses nor losses within the meaning of Section 23 of the 1939 Code. These were factual findings which unless clearly erroneous we cannot disturb. *United States v. United States Gypsum Co.*, 333 U. S. 364, 394 (1948).

The evidence showed that the laboratory sustained substantial net losses during every one of the seventeen years from the date of its inception in 1936 to the time of the Tax Court hearing in 1953. More important, there was no evidence of any reasonable possibility of the laboratory's ever generating gross income sufficient to offset its expenses. In the light of this and the other evidence of record, we think the Tax Court's findings were not clearly erroneous, and that its resultant decision was correct.

It is true, as the Tax Court took pains to point out, that the taxpayer through this ballistics laboratory performed worthy and useful services for private industry and for the federal government. The essential that was

missing, however, was a profit motive on the part of the taxpayer. *Thacher v. Lowe,* 288 Fed. 994 (S. D. N. Y., 1922); *Coffey v. Commissioner of Internal Revenue,* 141 F. (2d) 204 (5 Cir., 1944); *Morton v. Commissioner of Internal Revenue,* 174 F. (2d) 302, 303 (2 Cir., 1949); *Ewing v. Commissioner of Internal Revenue,* 213 F. (2d) 438 (2 Cir., 1954). It is that which distinguishes this case from those cited by the petitioners, where the taxpayers' activities were perhaps less worthy, but where a profit motive could reasonably be found to exist. *Commissioner of Internal Revenue v. Widener,* 33 F. (2d) 833 (3 Cir., 1929); *Whitney v. Commissioner of Internal Revenue,* 73 F. (2d) 589 (3 Cir., 1934); *Farish v. Commissioner of Internal Revenue,* 103 F. (2d) 63 (5 Cir., 1939).

The decision of the Tax Court is affirmed.

JUDGMENT.

(Filed December 16, 1955.)

On Petition to Review a decision of the Tax Court of the United States.

This cause came on to be heard on the transcript of record from the Tax Court of the United States, and was argued by counsel.

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this court that the decision of the said Tax Court in this cause be and the same is hereby affirmed.

ORDER DENYING REHEARING.

(Filed January 13, 1956.)

The petition for rehearing is denied.

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In the Supreme Court of the United States

OCTOBER TERM, 1955

No. 841

HENRY P. WHITE, AND ESTATE OF NANCY A. WHITE, DECEASED, T. LEO SULLIVAN, ADMINISTRATOR, C. T. A., PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (Pet. 21–28) are reported at 23 T. C. 90. The opinion of the Court of Appeals (Pet. 28–30) is reported at 227 F. 2d 779.

JURISDICTION

The judgment of the Court of Appeals, affirming the Tax Court's decision in favor of the Commissioner, was filed December 16, 1955. (Pet. 30.) The order of the Court of Appeals denying taxpayers' petition for rehearing was filed on

January 13, 1956. (Pet. 30.) The petition for a writ of certiorari was filed on April 9, 1956. The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254.

QUESTION PRESENTED

Whether the ballistics laboratory owned by the taxpayer was operated during the taxable years with the intention of making a profit.

STATUTE INVOLVED

Internal Revenue Code of 1939:

> SEC. 23. DEDUCTIONS FROM GROSS INCOME.
>
> In computing net income there shall be allowed as deductions:
>
> (a) [as amended by Sec. 121, Revenue Act of 1942, c. 619, 56 Stat. 798] *Expenses.*—
>
> (1) *Trade or business expenses.*—
>
> * * * * *
>
> (e) *Losses by Individuals.*—In the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—
>
> (1) if incurred in trade or business; or
>
> (2) if incurred in any transaction entered into for profit, though not connected with the trade or business;
>
> * * * * *

(26 U. S. C. 1952 ed., Sec. 23.)

STATEMENT

The facts as found by the Tax Court are as follows:

In 1934, Henry P. White was graduated from Cornell University with a degree in engineering and was licensed as a mechanical engineer by the States of Ohio and Maryland. He sold automobiles for the remainder of 1934 and was employed by a bank in Cleveland in 1935. In 1935 he became the beneficiary under a trust of approximately two million dollars. (Pet. 22.)

In 1936, he opened a ballistics laboratory in Cleveland, Ohio, specializing in guns and ammunition research. He employed others to assist him in such work. The laboratory was operated under White's direct supervision until he went into the armed forces; while he was absent from the laboratory and in the armed forces, the laboratory was operated under the supervision of his first assistant. On his return from the service, White again assumed the direction and management of the laboratory and it has continued under his supervision through the years in question. The laboratory is now located at Bel Air, Maryland, in proximity to the Army and Navy Proving Grounds. (Pet. 22.)

Operation of the laboratory included research and preparation for the publication of two books concerning pistol and revolver cartridges. One of these books was published in 1948 and the

other in 1950; income from the sales of the first book did not exceed $500 during the taxable years. No attempt was made during the taxable years to segregate expenditures properly attributable to producing the copyrighted publications and laboratory research library data, although most of the endeavors of White and his associates were connected with such activities. (Pet. 22.)

White devoted about one-half of his time to the preservation and conservation of his estate during 1948 and 1949. The general manager of the laboratory also spent one-half of his time on White's personal affairs. White used an arbitrary method of allocating the general manager's salary according to the time which was spent on the laboratory affairs and White's personal affairs. (Pet. 23.)

The joint income tax returns filed by White and his wife reported income a l expenses relating to the operation of the laboratory as follows (Pet. 23–24):

	1948	1949
Income	$730.10	$2,502.26
Expenses (less administration of investments)	19,354.92	21,023.28
Net loss	18,624.82	18,521.02

Of the $730.10 income received from the operation of the laboratory in 1948, $625 was acquired in fees for writing articles for the National Rifle Association. (Pet. 24–25.)

The laboratory served and benefited a limited number of persons and organizations, but was not capable of producing income in amounts sufficient to offset the usual expenses. White has never made a profit from the operation of the laboratory; rather its operations have resulted in losses in each of the 17 years from its inception in 1936 to the time of the trial in 1953. The joint income tax return filed by White and his wife for the year 1951 disclosed a loss of $33,369 from the laboratory operations. (Pet. 25.)

Subsequent to the taxable years White made an investment of $300,000 for the construction of a new laboratory in Maryland. In determining whether his new enterprise would be profitable, he did not take into account any amount for interest on that investment or for the value of his own services. He had no real expectation of any net income for years subsequent to the taxable years. (Pet. 25.)

On these facts the Tax Court found that White did not operate the laboratory as a business or with the intention of making a profit during the years 1948 and 1949. It concluded that the claimed expenditures were neither ordinary and necessary expenses of carrying on a trade or business nor losses within the meaning of Section 23 of the Internal Revenue Code of 1939. (Pet. 25.) The Court of Appeals, in a *per curiam* opinion, affirmed. (Pet. 28–30.)

ARGUMENT

There is no basis for further review of this case. The issue presented is one of fact and was correctly decided by the Court of Appeals and the Tax Court.

1. In order that an expenditure be incurred in the operation of a trade or business, within the meaning of the Code, it is necessary that the operation be entered into with the primary intention of profiting therefrom. *Helvering* v. *Nat. Grocery Co.*, 304 U. S. 282, 289 (fn. 5); *Thacher* v. *Lowe*, 288 Fed. 994 (S. D. N. Y.); *Coffey* v. *Commissioner*, 141 F. 2d 204 (C. A. 5); *Morton* v. *Commissioner*, 174 F. 2d 302, 303 (C. A. 2), certiorari denied, 338 U. S. 828; cf. *Ewing* v. *Commissioner*, 213 F. 2d 438 (C. A. 2). Whether such an intention exists is a factual question to be determined by the trier of fact. *Coffey* v. *Commissioner, supra; Morton* v. *Commissioner, supra.* This test was applied in the instant case by both the Tax Court (Pet. 25–28) and the Court of Appeals (Pet. 28–30). After a careful review of the evidence each court below resolved this question adversely to the taxpayers. This concurrent finding is entitled to finality, in the absence of unusual circumstances. Cf. *Comstock* v. *Group of Investors*, 335 U. S. 211, 213–214; *Allen* v. *Trust Co.*, 326 U. S. 630, 636; *Tennessee Coal Co.* v. *Muscoda Local*, 321 U. S. 590, 605.

2. There is no conflict with *Doggett* v. *Burnet*, 65 F. 2d 191 (App. D. C.). In the *Doggett* case

the Board of Tax Appeals (see 65 F. 2d 191, 193) had taken the view that the claimed deductions must be disallowed since the taxpayer had failed to show that the enterprise was profitable or would be profitable. This test the Court of Appeals rejected as being too narrow, citing with approval (p. 193) Judge Learned Hand's statement in *Thacher* v. *Lowe, supra,* that "The test appears to me to be only of his actual intention." The Court of Appeals stated (65 F. 2d 191, 194):

> The proper test is not the reasonableness of the taxpayer's belief that a profit will be realized, *but whether it is entered into and carried on in good faith and for the purpose of making a profit, or in the belief that a profit can be realized thereon,* * * *. [Emphasis supplied.]

The holding below is plainly not in conflict with this.[1] On the contrary, the court below stated (Pet. 29–30):

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[1] In this connection, *Chaloner* v. *Helvering*, 69 F. 2d 571 (C. A. D. C.), a later decision of the Court of Appeals for the District of Columbia Circuit, should be noted. In that case, on the facts presented, the Court of Appeals applied the same test and disallowed the deductions claimed by the taxpayer since the necessary profit motive was not present.

The taxpayers admit (Pet. 15) that *Cecil* v. *Commissioner*, 100 F. 2d 896 (C. A. 4th); *Whitney* v. *Commissioner*, 73 F. 2d 589 (C. A. 3d); and *Commissioner* v. *Widener*, 33 F. 2d 833 (C. A. 3d), relied on by them, fall "short of a square conflict." The latter two of these cases were distinguished by the court below on the ground that on the facts presented in those cases "a profit motive could reasonably be found to exist." (Pet. 30.) In *Cecil* v. *Commissioner*, *supra*, the

It is true, as the Tax Court took pains to point out, that the taxpayer through this ballistics laboratory performed worthy and useful services for private industry and for the federal government. The essential that was missing, however, was a profit motive on the part of the taxpayer.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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MAY 1956.

"profit motive" test was applied, as in the instant case, but on the facts present therein a different result was reached. The taxpayers state (Pet. 17) that cases decided by this Court (*Deputy* v. *du Pont*, 308 U. S. 488; *McDonald* v. *Commissioner*, 323 U. S. 57; *United States* v. *Pyne*, 313 U. S. 127; and *Higgins* v. *Commissioner*, 312 U. S. 212) leave the definition of "trade or business" in doubt. These cases, however, arise in completely different contexts from that of the instant case and in none of them is doubt cast on the validity of the applicability of the "profit motive" test in circumstances such as are present here.

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In the Supreme Court of the United States

OCTOBER TERM, 1955.

No. 841.

HENRY P. WHITE, and
ESTATE OF NANCY A. WHITE, deceased,
T. LEO SULLIVAN, ADMINISTRATOR, *c.t.a.*,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITIONERS' REPLY BRIEF
In Support of Petition for Writ of Certiorari
To the United States Court of Appeals
For the Sixth Circuit.

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May 15, 1956.

THE GATES LEGAL PUBLISHING CO., CLEVELAND, OHIO—MAIN 1-9847

In the Supreme Court of the United States

OCTOBER TERM, 1955.

No. 841.

HENRY P. WHITE, and
ESTATE OF NANCY A. WHITE, deceased,
T. LEO SULLIVAN, ADMINISTRATOR, *c.t.a.*,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITIONERS' REPLY BRIEF.

Respondent, resisting review, relies on the wrong statute.

Quoting the "Statute Involved," Respondent (p. 2) sets forth § 23(e) and omits § 23(a).

Where a taxpayer claims a "trade or business" deduction under § 23(a)(1)(A)[1] it will not do to answer with rules applicable to a different statute, § 23(e). (As the Court will recall, § 23(a)(1)(A) allows "All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business;" the only statutory reference to "profit" occurs in § 23(e)(2), which Respondent quotes, and which allows, to an individual, losses "incurred in any transaction entered into *for profit.*")

Having launched the argument from an erroneous premise and upon the wrong statute, Respondent says the

[1] Internal Revenue Code of 1939; the same provision is in the present Code, § 162(a).

case raises only an issue of fact. Respondent is in error. The facts are not in question. The case raises only the question of law whether the court below has applied the wrong standard in construing an important revenue statute by reading into it the "profit" standard Congress put into a different statute, but omitted from this.

The question is an important one.

The reports of the Courts of Appeals show contrariety of view. (Pet., pp. 8-10, 15-16.) The decisions of this Court leave the question unresolved. (Pet., pp. 17-18.)

The question should have the attention of this Court.

The writ should issue.

Respectfully submitted,

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May 15, 1956.